

Implementing Strategies: Marketing, Finance/ Accounting, R&D, and MIS Issues

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Develop effective perceptual maps to position rival firms.
2. Develop effective perceptual maps to identify market segments and demand voids.
3. Determine the cash worth of any business.
4. Explain market segmentation and product positioning as strategy-implementation tools.
5. Discuss procedures for determining the worth of a business.
6. Develop projected financial statements to reveal the impact of strategy recommendations.
7. Perform EPS-EBIT analysis to evaluate the attractiveness of debt versus stock as a source of capital to implement strategies.
8. Discuss the nature and role of research and development in strategy implementation.
9. Explain how management information systems can determine the success of strategy-implementation efforts.
10. Explain business analytics and data mining.

David + David
2015

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

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|--------------------|---|
| EXERCISE 8A | Develop Product Positioning Maps for PepsiCo |
| EXERCISE 8B | Gain Practice Developing Perceptual Maps |
| EXERCISE 8C | Perform an EPS/EBIT Analysis for PepsiCo |
| EXERCISE 8D | Prepare Projected Financial Statements for PepsiCo |
| EXERCISE 8E | Determine the Cash Value of PepsiCo |
| EXERCISE 8F | Develop a Product-Positioning Map for Your University |
| EXERCISE 8G | Do Banks Require Projected Financial Statements? |

Strategies have no chance of being implemented successfully in organizations that do not market goods and services well, in firms that cannot raise needed working capital, in firms that produce technologically inferior products, or in firms that have a weak information system. This chapter examines marketing, finance and accounting, research and development (R&D), and management information systems (MIS) issues that are central to effective strategy implementation. Special topics include market segmentation, market positioning, evaluating the worth of a business, determining to what extent debt or stock should be used as a source of capital, developing projected financial statements, contracting R&D outside the firm, and creating an information support system. Manager and employee involvement and participation are essential for success in marketing, finance and accounting, R&D, and MIS activities.

The Nature of Strategy Implementation

The quarterback can call the best play possible in the huddle, but that does not mean the play will go for a touchdown. The team may even lose yardage unless the play is executed (implemented) well. Less than 10 percent of strategies formulated are successfully implemented! There are many reasons for this low success rate, including failing to appropriately segment markets, paying too much for a new acquisition, and falling behind competitors in R&D. Panera Bread implements strategies especially well.

Strategy implementation directly affects the lives of plant managers, division managers, department managers, sales managers, product managers, project managers, personnel managers, staff managers, supervisors, and all employees. In some situations, individuals may not have participated in the strategy-formulation process at all and may not appreciate, understand, or even accept the work and thought that went into strategy formulation. There may even be foot dragging or resistance on their part. Managers and employees who do not understand the business and are not committed to the business may attempt to sabotage strategy-implementation efforts in hopes that the organization will return to its old ways. The strategy-implementation stage of the strategic-management process is highlighted in Figure 8-1 as illustrated with white shading.

EXCELLENT STRATEGIC MANAGEMENT SHOWCASED

Panera Bread Co.

Have you ever eaten at Panera Bread, a leader in the quick-casual restaurant business with 1,591 bakery-cafes in 40 states and Canada? Under the names Panera Bread, Saint Louis Bread Co., and Paradise Bakery & Café, Panera offers made-to-order sandwiches using a variety of artisan breads, including Asiago cheese bread, focaccia, and its classic sourdough bread. Panera's menu also features soups, salads, and gourmet coffees, as well as bread, bagels, and pastries to go. More than 660 of its locations are company-operated, whereas the rest are run by franchisees.

Panera Bread recently announced a new three-year share repurchase program to buy back up to \$600 million worth of its own common stock (called *treasury stock* on balance sheets). The stock buyback aims to reduce the number of shares outstanding from 30 million and is expected to reinforce shareholders' confidence and boost the market value of the outstanding shares.

Panera remains well positioned to increase store sales and accelerate unit growth in the long run with the introduction of a new menu to compete more effectively with the likes of Chipotle Mexican Grill, Einstein Voah Restaurant Group, and Atlanta Bread Company. Based in Richmond

Heights, Missouri, and founded in 1981, Panera Bread has 776 company owned bakery-cafes and the rest are franchised.

In July 2012, Panera Bread reported strong quarterly results with earnings of \$1.50 per share and revenue increases of 18 percent year-over-year to \$530.6 million. Panera's comparable net bakery-cafe sales expanded 5.9 percent. The company-owned comparable net bakery-cafe sales increased 7.1 percent whereas franchise-operated comparable net bakery-cafe sales grew 4.8 percent. Panera reported a 27 percent rise in earnings and an 18 percent sales increase in that quarter.

Source: A variety of sources.

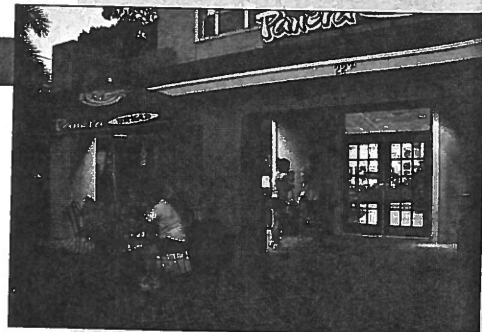


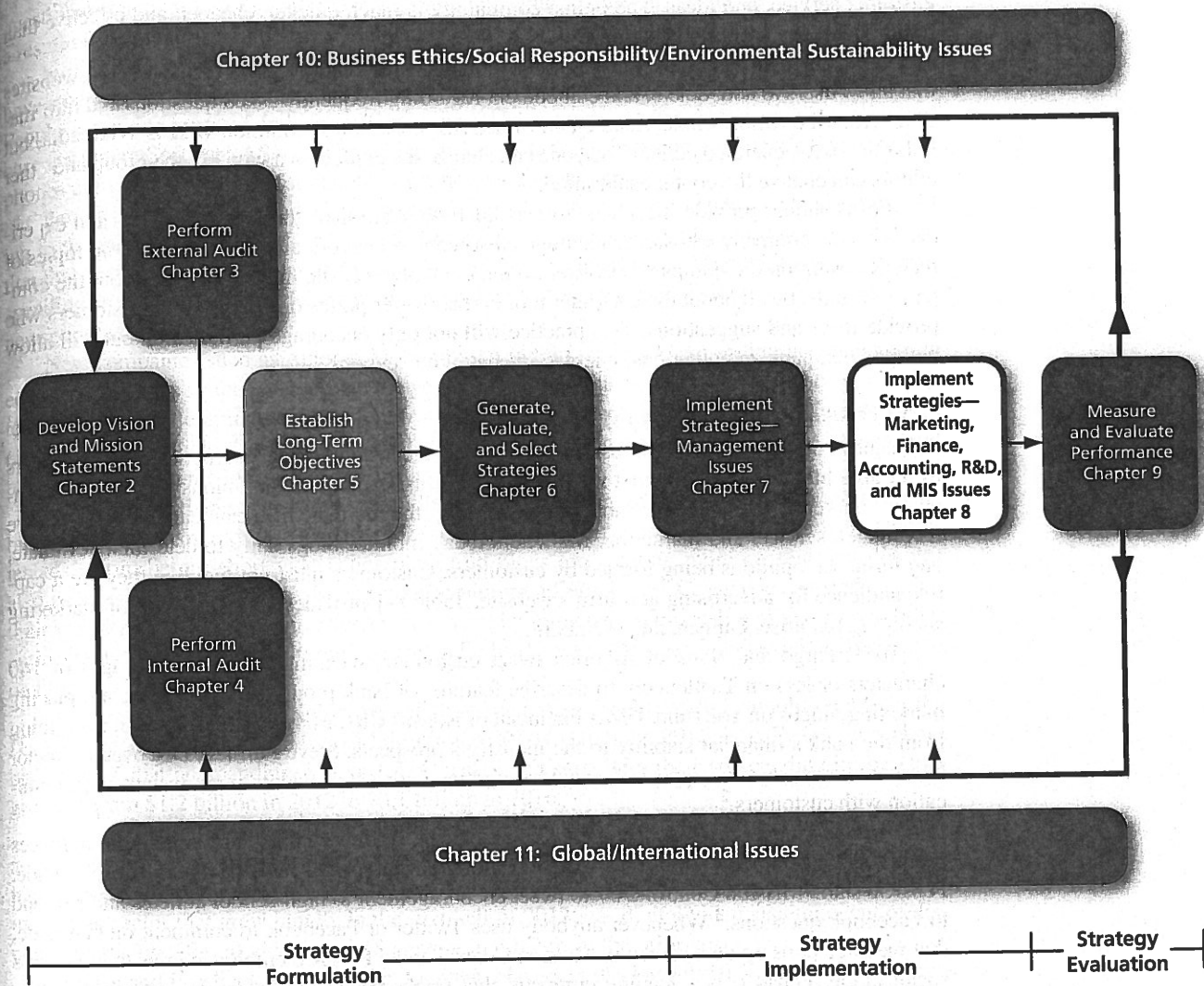
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**FIGURE 8-1****A Comprehensive Strategic-Management Model**

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Current Marketing Issues

Countless marketing variables affect the success or failure of strategy implementation efforts. Some example marketing decisions that may require policies are as follows:

1. How to make advertisements more interactive to be more effective
2. How to best take advantage of Facebook and Twitter conversations about the company and industry
3. To use exclusive dealerships or multiple channels of distribution
4. To use heavy, light, or no TV advertising versus online advertising
5. To limit (or not) the share of business done with a single customer
6. To be a price leader or a price follower
7. To offer a complete or limited warranty
8. To reward salespeople based on straight salary, straight commission, or a combination salary and commission

Marketing is more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers today must get their customers involved in their company website and solicit suggestions from customers in terms of product development,

customer service, and ideas. The online community is much quicker, cheaper, and effective than traditional focus groups and surveys.

Companies and organizations should encourage their employees to create **wikis**—websites that allow users to add, delete, and edit content regarding frequently asked questions and information across the firm's whole value chain of activities. The most common wiki is Wikipedia, but wikis are user-generated content. Anyone can change the content in a wiki but the group and other editors can change the content submitted.

Firms should provide incentives to customers to share their thoughts, opinions, and experiences on the company website. Encourage customers to network among themselves on topics of their choosing on the company website. So the company website must not be all about the company—it must be all about the customer too. Perhaps offer points or discounts for customers who provide ideas and suggestions. This practice will not only encourage participation but will allow both the company and other customers to interact with “experts.”

New Principles of Marketing

A business or organization's website must provide clear and simple instructions for customers to set up a blog or contribute to a wiki. Customers trust each others' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and marketing. Marketers today monitor blogs daily to determine, evaluate, and influence opinions being formed by customers. Customers must not feel like they are a captive audience for advertising at a firm's website. Table 8-1 provides new principles of marketing according to Parise, Guinan, and Weinberg.¹

Wells Fargo and Bank of America **tweet** customers, meaning they post messages of 140 characters or less on Twitter.com to describe features of bank products. Some banks are placing marketing videos on YouTube. UMB Financial of Kansas City, Missouri, tweets about everything from the bank's financial stability to the industry's prospects. Steve Furman, Discover's director of e-commerce, says the appeal of social networking is that it provides “pure, instant” communication with customers.²

PepsiCo recently established a “Mission Control” staffed with social marketing employees promoting the company's long-time product Gatorade, which had been on a three-year sales slide. PepsiCo staffs Mission Control 24/7 to tweet encouragement to high-school athletes and respond to Facebook questions.³ Whenever anybody uses Twitter or Facebook to comment on Gatorade, that message pops up on a screen in Mission Control and a PepsiCo employee joins that person's social circle. PepsiCo is a leading company that tracks social media, tracks online-ad traffic, heads off potential crises, builds support for products, and monitors consumer behavior in depth. Gatorade is under intense pressure from Coca-Cola's Powerade, whose sales are increasing in contrast to Gatorade's sales decreasing.

Although the exponential increase in social networking and business online has created huge opportunities for marketers, it also has produced some severe threats. Perhaps the greatest threat is that any kind of negative publicity travels fast online. For example, Taco Bell suffered from its ads that featured asking 50 Cent (aka Curtis Jackson) if he would change his name to 79 Cent or 89 Cent for a day in exchange for a \$10,000 donation to charity. Seemingly minor ethical and

TABLE 8-1 The New Principles of Marketing

1. Do not just talk at consumers—work with them throughout the marketing process.
2. Give consumers a reason to participate.
3. Listen to—and join—the conversation outside your company's website.
4. Resist the temptation to sell, sell, sell. Instead attract, attract, attract.
5. Do not control online conversations; let it flow freely.
6. Find a “marketing technologist,” a person who has three excellent skill sets (marketing, technology, and social interaction).
7. Embrace instant messaging and chatting.

Source: Based on Salvatore Parise, Patricia Guinan, and Bruce Weinberg, “The Secrets of Marketing in a Web 2.0 World,” *Wall Street Journal*, December 15, 2008, R1.

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questionable actions can catapult these days into huge public relations problems for companies as a result of the monumental online social and business communications.

In increasing numbers, people living in underdeveloped and poor nations around the world have smartphones but no computers. This is opening up even larger markets to online marketing. People in remote parts of Indonesia, Egypt, and Africa represent the fastest-growing customer base for Opera Software ASA, a Norwegian maker of Internet browsers for mobile devices. Cell phones are widely used now for data transfer, not just for phone calls.⁴

People ages 18 to 27 spend more time weekly on the Internet than watching television, listening to the radio, or watching DVDs or VHS tapes. Companies are rapidly coming to the realization that social networking sites and video sites are better means of reaching their customers than spending so many marketing dollars on traditional yellow pages or television, magazine, radio, or newspaper ads.

New companies such as Autonet Mobile based in San Francisco are selling new technology equipment for cars so that everyone in the vehicle can be online except, of course, the driver. This technology is accelerating the movement from hard media to web-based media. With this technology, when the vehicle drives into a new location, information on shows, museums, hotels, and other attractions in the location can be instantly downloaded.

Internet advertising is growing so rapidly that marketers are more and more allowed to create bigger, more intrusive ads that take up more space on the web page. Websites are allowing lengthier ads to run before short video clips play. And blogs are creating more content that doubles also as an ad. Companies are also waiving minimum ad purchases. Companies are redesigning their websites to be much more interactive and are building new sponsorship programs and other enticements on their sites. Editorial content and advertising content are increasingly being mixed on blogs.

A recent report by BIA/Kelsey reveals that social media ad spending should double in the USA between 2012 and 2016 from \$4.8 billion to \$9.6+ billion by 2016. BIA/Kelsey says about one-third of that ad spending will be from local advertisers, with their ad spending in the USA growing from \$1.2 billion in 2012 to \$3.1 billion in 2016.

According to the Interactive Advertising Bureau and Pricewaterhouse Coopers, mobile advertising grew 95 percent in the first half of 2012. The industry as a whole grew to an all-time high of \$17 billion in revenues in the first half of 2012, up 14 percent over the prior year. Another marketing sector that grew rapidly in the first half of 2012 was digital video, a component of display advertising. Digital video grew 18 percent in 2012 from the prior year.

Google and Facebook are by far the dominant players in display advertising, together comprising 30 percent of the overall market in 2012. An eMarketer report predicts those two companies alone will sell 37 percent of all display ads by the end of 2014. Google had 15.4 percent of the market in 2012 (\$2.31 billion) compared to Facebook's 14.4 percent (\$2.16 billion). Yahoo! once dominated the display ad market but is on the decline with 9.3 percent of the market (\$1.39 billion).

Market Segmentation

Two variables are of central importance to strategy implementation: **market segmentation** and **product positioning**. Market segmentation and product positioning rank as marketing's most important contributions to strategic management.

Market segmentation is widely used in implementing strategies, especially for small and specialized firms. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits.

eBay recently initiated a new market segmentation strategy to target consumers under 18 years old. "We're definitely looking at ways to legitimately bring younger people in," said Devin Wenig at eBay. "We won't allow a 15-year-old unfettered access to the site. We would want a parent, an adult as a ride-along." The under 18-age group are an increasingly savvy and desirable consumer segment for many businesses.

Market segmentation is an important variable in strategy implementation for at least three major reasons. First, strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products. To implement these strategies successfully, new or improved market-segmentation approaches are required. Second, market segmentation allows a firm to operate with limited resources because

mass production, mass distribution, and mass advertising are not required. Market segmentation enables a small firm to compete successfully with a large firm by maximizing per-unit profits and per-segment sales. Finally, market segmentation decisions directly affect **marketing mix variables**: product, place, promotion, and price, as indicated in Table 8-2.

Perhaps the most dramatic new market-segmentation strategy is the targeting of regional tastes. Firms from Pizza Hut to Honda Motors are increasingly modifying their products to meet different regional preferences of customers around the world. Campbell's has a spicier version of its nacho cheese soup for the Southwest, and Burger King offers breakfast burritos in New Mexico but not in South Carolina. Geographic and demographic bases for segmenting markets are the most commonly employed, as illustrated in Table 8-3.

Evaluating potential market segments requires strategists to determine the characteristics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles. Segmenting consumer markets is generally much simpler and easier than segmenting industrial markets, because industrial products, such as electronic circuits and forklifts, have multiple applications and appeal to diverse customer groups.

Segmentation is a key to matching supply and demand, which is one of the thorniest problems in customer service. Segmentation often reveals that large, random fluctuations in demand actually consist of several small, predictable, and manageable patterns. Matching supply and demand allows factories to produce desirable levels without extra shifts, overtime, and subcontracting. Matching supply and demand also minimizes the number and severity of stock-outs. The demand for hotel rooms, for example, can be dependent on foreign tourists, businesspersons, and vacationers. Focusing separately on these three market segments, however, can allow hotel firms to more effectively predict overall supply and demand.

Banks now are segmenting markets to increase effectiveness. "You're dead in the water if you aren't segmenting the market," says Anne Moore, president of a bank consulting firm in Atlanta. The Internet makes market segmentation easier today because consumers naturally form "communities" on the Web.

Retention-Based Segmentation

To aid in more effective and efficient deployment of marketing resources, companies commonly tag each of their active customers with three values:

Tag 1: Is this customer at high risk of canceling the company's service? One of the most common indicators of high-risk customers is a drop off in usage of the company's service. For example, in the credit card industry this could be signaled through a customer's decline in spending on his or her card.

Tag 2: Is this customer worth retaining? This determination boils down to whether the postretention profit generated from the customer is predicted to be greater than the cost incurred to retain the customer. Customers need to be managed as investments.

Tag 3: What retention tactics should be used to retain this customer? For customers who are deemed "save-worthy," it is essential for the company to know which save tactics are most likely

TABLE 8-2 The Marketing Mix Component Variables

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and options	Distribution coverage	Personal selling	Discounts and allowances
Style	Outlet location	Sales promotion	Payment terms
Brand name	Sales territories	Publicity	
Packaging	Inventory levels and locations		
Product line	Transportation carriers		
Warranty			
Service level			
Other services			

Source: Based on E. Jerome McCarthy, *Basic Marketing: A Managerial Approach*, 9th ed. (Homewood, IL: Richard D. Irwin, Inc., 1987), 37-44. Used with permission.

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TABLE 8-3 Alternative Bases for Market Segmentation

Variable	Typical Breakdowns
<i>Geographic</i>	
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
County Size	A, B, C, D
City Size	Under 5,000; 5,000–20,000; 20,001–50,000; 50,001–100,000; 100,001–250,000; 250,001–500,000; 500,001–1,000,000; 1,000,001–4,000,000; 4,000,001 or over
Density	Urban, suburban, rural
Climate	Northern, southern
<i>Demographic</i>	
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Gender	Male, female
Family Size	1–2, 3–4, 5+
Family Life Cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Income	Under \$10,000; \$10,001–\$15,000; \$15,001–\$20,000; \$20,001–\$30,000; \$30,001–\$50,000; \$50,001–\$70,000; \$70,001–\$100,000; over \$100,000
Occupation	Professional and technical; managers, officials, and proprietors; clerical and sales; craftspeople; foremen; operatives; farmers; retirees; students; housewives; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Islamic, other
Race	White, Asian, Hispanic, African American
Nationality	American, British, French, German, Scandinavian, Italian, Latin American, Middle Eastern, Japanese
<i>Psychographic</i>	
Social Class	Lower lowers, upper lowers, lower middles, upper middles, lower uppers, upper uppers
Personality	Compulsive, gregarious, authoritarian, ambitious
<i>Behavioral</i>	
Use Occasion	Regular occasion, special occasion
Benefits Sought	Quality, service, economy
User Status	Nonuser, ex-user, potential user, first-time user, regular user
Usage Rate	Light user, medium user, heavy user
Loyalty Status	None, medium, strong, absolute
Readiness Stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude Toward Product	Enthusiastic, positive, indifferent, negative, hostile

Source: Adapted from Philip Kotler, *Marketing Management: Analysis, Planning and Control*, © 1984: 256. Adapted by permission of Prentice-Hall, Inc., Upper Saddle River, New Jersey.

to be successful. Tactics commonly used range from providing “special” customer discounts to sending customers communications that reinforce the value proposition of the given service.⁵

The basic approach to tagging customers is to use historical retention data to make predictions about active customers regarding:

- Whether they are at high risk of canceling their service
- Whether they are profitable to retain
- What retention tactics are likely to be most effective

The idea with retention-based segmentation is to match up active customers with customers from historic retention data who share similar attributes. Using the theory that “birds of a feather flock together,” the approach is based on the assumption that active customers will have similar retention outcomes as those of their comparable predecessor. This whole process is possible through business analytics or data mining (discussed later in this chapter).

Does the Internet Make Market Segmentation Easier?

Yes. The segments of people whom marketers want to reach online are much more precisely defined than the segments of people reached through traditional forms of media, such as television, radio, and magazines. People all over the world are congregating into virtual communities on the web by becoming members, customers, and visitors of websites that focus on an endless range of topics. People in essence segment themselves by nature of the websites that comprise their “favorite places,” and many of these websites sell information regarding their “visitors.” Businesses and groups of individuals all over the world pool their purchasing power in websites to get volume discounts.

Through its Connect feature, Facebook recently introduced a type of mobile advertising that targets consumers based on the apps they use from their phone. Connect lets users log into millions of websites and apps with their Facebook identity, so the company then targets ads based on that data. Facebook can also track what people do on their apps. Although Apple and Google also track users’ mobile apps, those two firms disclose to users in their privacy policy that they can target ads based on apps the person has downloaded from its App Store and iTunes. Facebook charges advertisers every time an app is installed on a users’ smartphone.⁶ Privacy advocates contend that Facebook should provide ways for users to opt out of the mobile ad targeting.

Product Positioning/Perceptual Mapping

After markets have been segmented so that the firm can target particular customer groups, the next step is to find out what customers want and expect. This takes analysis and research. A severe mistake is to assume the firm knows what customers want and expect. Countless research studies reveal large differences between how customers define service and rank the importance of different service activities and how producers view services. Many firms have become successful by filling the gap between what customers and producers see as good service. What the customer believes is good service is paramount, not what the producer believes service should be.

Identifying target customers on which to focus marketing efforts sets the stage for deciding how to meet the needs and wants of particular consumer groups. Product positioning is widely used for this purpose. Positioning entails developing schematic representations that reflect how products or services compare to competitors’ on dimensions most important to success in the industry. The following steps are required in product positioning (sometimes called perceptual mapping):

1. Select key criteria that effectively differentiate products or services in the industry.
2. Diagram a two-dimensional product-positioning map with specified criteria on each axis.
3. Plot major competitors’ products or services in the resultant four-quadrant matrix.
4. Identify areas in the positioning map where the company’s products or services could be most competitive in the given target market. Look for vacant areas (niches).
5. Develop a marketing plan to position the company’s products or services appropriately.

Because just two criteria can be examined on a single product-positioning (perceptual) map, multiple maps are often developed to assess various approaches to strategy implementation. **Multidimensional scaling** could be used to examine three or more criteria simultaneously, but this technique requires computer assistance and is beyond the scope of this text.

Some rules for using product positioning as a strategy-implementation tool are the following:

1. Look for the hole or **vacant niche**. The best strategic opportunity might be an unserved segment.
2. Do not serve two segments with the same strategy. Usually, a strategy successful with one segment cannot be directly transferred to another segment.
3. Do not position yourself in the middle of the map. The middle usually means a strategy that is not clearly perceived to have any distinguishing characteristics. This rule can vary with the number of competitors. For example, when there are only two competitors, as in U.S. presidential elections, the middle becomes the preferred strategic position.⁷

An effective product-positioning strategy meets two criteria: (1) it uniquely distinguishes a company from the competition, and (2) it leads customers to expect slightly less service than a company can deliver. Network Equipment Technology is an example of a company that keeps customer expectations slightly below perceived performance. This is a constant challenge for marketers. Firms need to inform customers about what to expect and then exceed the promise. Underpromise and then overdeliver is the key!

The product positioning map, or **perceptual map**, in Figure 8-2, shows consumer perceptions of various automobiles on the two dimensions of sportiness and conservative and classy and affordable. This sample of consumers felt Porsche was the sportiest and classiest of the cars in the study (top right corner). They felt Plymouth was most practical and conservative (bottom left corner). Car manufacturers could focus their marketing efforts on various target groups, or even redesign features in their vehicles, based on research and survey information illustrated in perceptual maps. Perceptual maps can aid marketers in being more effective in spending money to promote products. Products, brands, or companies positioned close to one another are perceived as similar on the relevant dimensions. For example, in Figure 8-2, consumers see Buick, Chrysler, and Oldsmobile as similar. They are close competitors and form a competitive grouping. A company considering the introduction of a new or improved model may look for a vacant niche on a perceptual map. Some perceptual maps use different size circles to indicate the sales volume or market share of the various competing products.

Perceptual maps may also display consumers' ideal points. These points reflect ideal combinations of the two dimensions as seen by a consumer. Figure 8-3 reveals the results of a study of consumers' ideal points in the alcohol and spirits product space. Each dot represents one respondent's ideal combination of the two dimensions. Areas where there is a cluster of ideal points (such as A) indicates a **market segment**. Areas without ideal points are sometimes referred to as **demand voids**. A company considering introducing a new product will look for areas with a high density of ideal points. They will also look for areas without competitive rivals (a vacant niche), perhaps best done by placing both the (1) ideal points and (2) competing products on the same map.

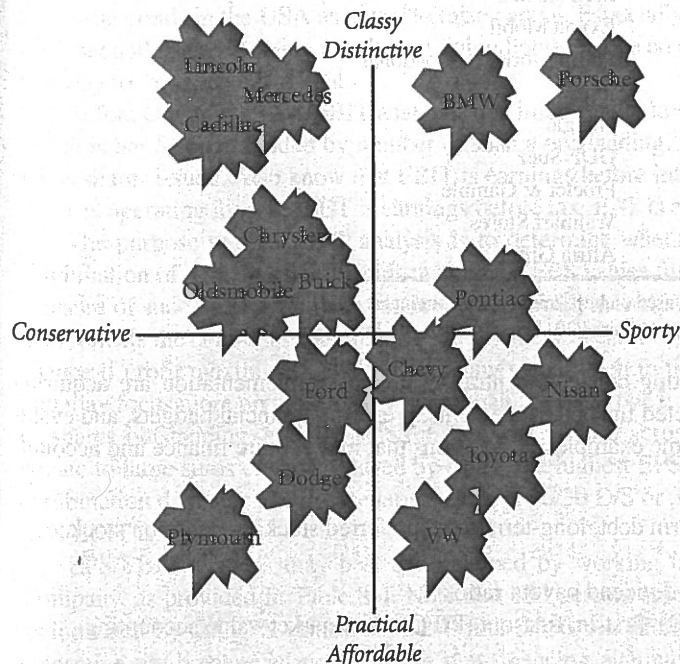


FIGURE 8-2
A Perceptual Map for the Automobile Industry

Source: Based on info at http://en.wikipedia.org/wiki/Perceptual_mapping.

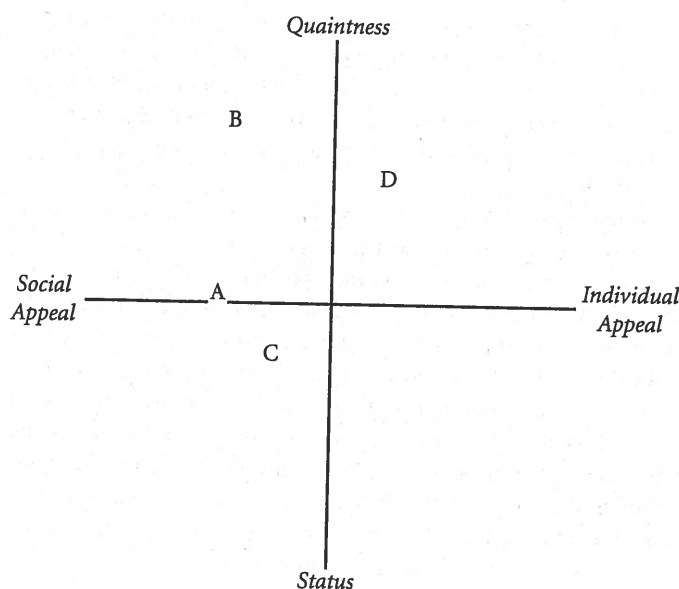


FIGURE 8-3
A Perceptual Map for the Alcohol and Spirits Industry

Source: Based on info at http://en.wikipedia.org/wiki/Perceptual_mapping.

Finance and Accounting Issues

In terms of "Financial Soundness," *Fortune* recently ranked the following companies as best in the world:

Rank	Company
1	Apple
2	McDonald's
3	Exxon Mobil
4	Philip Morris International
5	Intel
6	Google
7	GDF Suez
8	Procter & Gamble
9	Walmart Stores
10	Altria Group

Source: Based on http://money.cnn.com/magazines/fortune/mostadmired/2012/best_worst/best6.html.

Several finance and accounting concepts central to strategy implementation are acquiring needed capital, developing projected financial statements, preparing financial budgets, and evaluating the worth of a business. Some examples of decisions that may require finance and accounting policies are these:

1. To raise capital with short-term debt, long-term debt, preferred stock, or common stock
2. To lease or buy fixed assets
3. To determine an appropriate dividend payout ratio
4. To use last-in, first-out (LIFO), first-in, first-out (FIFO), or a market-value accounting approach
5. To extend the time of accounts receivable
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash that should be kept on hand

Acquiring Capital to Implement Strategies

When students complete their recommendations page as part of a case analysis, or in actual company practice when a firm decides what strategies to pursue, it is necessary to address the questions: 1) Should the company obtain needed capital via stock or debt? 2) What would the firm's expected/projected EBIT values be given our recommendations?

Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An **earnings per share/earnings before interest and taxes (EPS/EBIT) analysis** is the most widely used technique for determining whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. This technique involves an examination of the impact that debt versus stock financing has on earnings per share under various expectations for EBIT given specific recommendations (strategies to be implemented).

Theoretically, an enterprise should have enough debt in its capital structure to boost its return on investment by applying debt to products and projects earning more than the cost of the debt. In low-earning periods, too much debt in the capital structure of an organization can endanger stockholders' returns and jeopardize company survival. Fixed debt obligations generally must be met, regardless of circumstances. This does not mean that stock issuances are always better than debt for raising capital. When the cost of capital (interest rates) is low, such as in 2012/2013, debt may be better than stock to obtain capital, but the analysis still must be performed because high stock prices usually accompany low interest rates, making stock issuances attractive for obtaining capital. Some special concerns with stock issuances are dilution of ownership, effect on stock price, and the need to share future earnings with all new shareholders. Facebook's initial public offering in early 2012 was for \$38 per share, but several months later the stock was selling for \$21, so it is no guarantee even with an IPO that a firm's stock price will rise.

Another popular way for a company to raise capital is to issue corporate bonds, which is analogous to going to the bank and borrowing money, except that with bonds the company obtains the funds from investors rather than banks. Through the first seven months of 2012, companies sold almost \$584 billion of bonds in the USA, according to Dealogic, up 6.5 percent from the same period in 2011.⁸ For example, Bristol-Myers Squibb, a company with single-A investment credit ratings, sold \$2 billion of bonds that paid 3.35 percent interest. Many foreign companies also issue bonds in the USA as a way to raise capital. Especially when a company's balance sheet is strong and its credit rating excellent, issuing bonds can be an effective, and certainly an alternative way to raise needed capital.

Before explaining EPS/EBIT analysis, it is important to know that EPS is earnings per share, which is net income divided by number of shares outstanding. Another term for shares outstanding is shares issued. Also know that EBIT is earnings before interest and taxes. Another name for EBIT is operating income. EBT is earnings before tax. EAT is earnings after tax.

The purpose of EPS/EBIT analysis is to determine whether all debt, or all stock, or some combination of debt and stock yields the highest EPS values for the firm. EPS is perhaps the best measure of success of a company, so it is widely used in making the capital acquisition decision. EPS reflects the common "maximizing shareholders' wealth" overarching corporate objective. By chance if profit maximization is the company's goal, then in performing an EPS/EBIT analysis, you may focus more on the EAT row more than the EPS row. Large companies may have millions of shares outstanding, so even small differences in EPS across different financing options can equate to large sums of money saved by using that highest EPS value alternative. Any number of combination debt/stock (D/S) scenarios, such as 70/30 D/S or 30/70 D/S, may be examined in an EPS/EBIT analysis.

EPS/EBIT analysis may best be explained by working through an example for the XYZ Company, as provided in Table 8-4. Note that 100 percent stock is the best financing alternative as indicated by the EPS values of 0.0279 and 0.056. An EPS/EBIT chart can be constructed to determine the break-even point, where one financing alternative becomes more attractive than another. Figure 8-4 reveals that issuing common stock is the best financing alternative for the XYZ Company. As noted in Figure 8-4, the top row (EBIT) on the x-axis is graphed with the bottom row (EPS) on the y-axis, and the highest plotted line reveals the best method. Sometimes the

TABLE 8-4 EPS/EBIT Analysis for the XYZ Company

Input Data	The Number	How Determined
\$Amount of Capital Needed	\$100 million	Estimated \$cost of recommendations
EBIT Range	\$20 to \$40 million	Estimate based on prior year EBIT and recommendations for the coming year(s)
Interest Rate	5 percent	Estimate based on cost of capital
Tax Rate	30 percent	Use prior year %: taxes divided by income before taxes, as given on income statement
Stock Price	\$50	Use most recent stock price
#Shares Outstanding	500 million	For the debt columns, enter the existing #shares outstanding. For stock columns, use the existing #shares outstanding + the #new shares that must be issued to raise the needed capital, i.e., based on stock price. So divide the stock price into the \$amount of capital needed.

	100% Debt		100% Stock		50/50 Debt/Stock Combo	
\$ EBIT	20,000,000	40,000,000	20,000,000	40,000,000	20,000,000	40,000,000
\$ Interest	5,000,000	5,000,000	0	0	2,500,000	2,500,000
\$ EBT	15,000,000	35,000,000	20,000,000	40,000,000	17,500,000	37,500,000
\$ Taxes	4,500,000	10,500,000	6,000,000	12,000,000	5,250,000	11,250,000
\$ EAT	10,500,000	24,500,000	14,000,000	28,000,000	12,250,000	26,250,000
# Shares	500,000,000	500,000,000	502,000,000	502,000,000	501,000,000	501,000,000
\$ EPS	0.0210	0.049	0.0279	0.056	0.0245	0.0523

Conclusion—the best financing alternative is 100% stock because the EPS values are largest; the worst financing alternative is 100% debt because the EPS values are lowest.

plotted lines will interact, so a graph is especially helpful in making the capital acquisition decision, rather than solely relying on a table of numbers.

It is important to note some limitations of EPS-EBIT analysis. First, flexibility is a limitation. As an organization's capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future. Second, control is a limitation. When additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted. This can be a serious concern in today's business environment of hostile takeovers, mergers, and acquisitions. Dilution of ownership could be a problem, and if so, debt could be better than stock regardless of determined EPS values in the analysis. Third, interest rates are a limitation. If rates are expected to rise, as they are doing in 2013/2014, then debt could be better than stock, regardless of the determined EPS values in the analysis. Fourth, if the firm is already too highly leveraged vs. industry average ratios, then stock may be best regardless of determined EPS values in the analysis. A fifth limitation is that the analysis assumes stock price, tax rate, and interest rates to be the same over all economic conditions. A sixth limitation is that the estimated EBIT low and high values are based on the prior year plus the impact of strategies to be implemented. But considering these six potential limitations, unless you have a compelling reason to overturn the highest last row EPS values dictating the EPS-EBIT analysis, then indeed those values should dictate the financing decision, because EPS is arguably the best measure of organizational performance.

IBM declared a third quarter 2012 cash dividend of \$0.85 per common share, marking the third consecutive quarterly payout at that rate. IBM also authorized another \$5 billion in additional funds to be used for its share repurchase program on top of the \$6.7 billion remaining available for buybacks. That was \$11.7 billion for its stock repurchase program in total or about 5.3 percent of its outstanding shares. IBM and thousands of other firms lately have significantly increased their share repurchases.

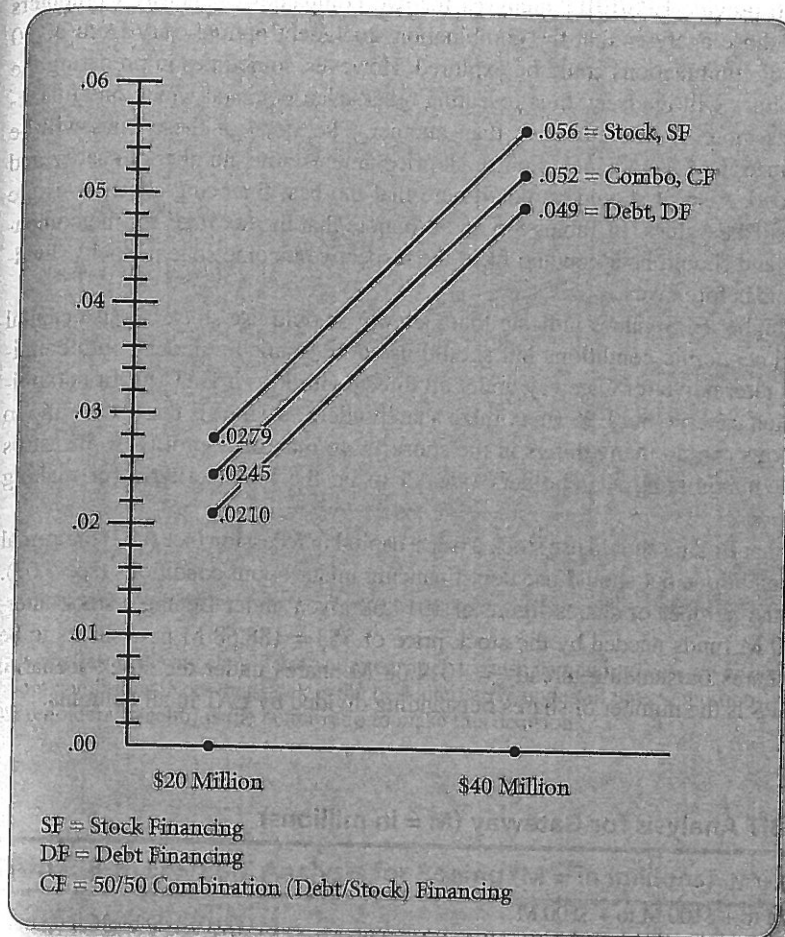


FIGURE 8-4
An EPS/EBIT Chart for the XYZ Company

Lowe's Companies is aggressively buying its own stock, increasing its **Treasury Stock** on its balance sheets. Many analysts say stock buybacks reflect optimism among companies and say it is a good sign. However, other analysts argue that buybacks eat cash that a firm could better use to grow the firm. Intel in late 2012 borrowed \$6 billion to buy back more of its own stock. The low interest rate environment has spurred this activity. Even though Intel had the cash on its balance sheet to cover the transaction, the firm, like many large U.S. firms, have most of their cash in overseas accounts (that is, a large percentage of their revenues were derived in foreign countries). Many such firms prefer to leave their cash outside the USA because to use those funds to pay dividends or purchase treasury stock, for example, would trigger a big U.S. corporate income tax payment.

When using EPS/EBIT analysis, timing in relation to movements of stock prices, interest rates, and bond prices becomes important. In times of high stock prices, such as in 2013/2014, stock may prove to be the best alternative from both a cost and a demand standpoint. However, when cost of capital (interest rates) is low, debt is more attractive.

The USA has \$9.7 trillion in outstanding debt, equal to 63 percent of gross domestic product (GDP). Based on that percentage, S&P lowered the U.S.'s AAA credit rating. It is interesting, however, that 147 of the S&P 500 companies have total debt that is 63 percent or greater than the company's revenue. For example, GE, Lennar, and Harley-Davidson have debt that is 300, 131, and 116 percent greater than their revenues, respectively. A key difference of course is that companies generate money whereas governments consume money. The U.S. government pays \$210 billion in interest annually, about 10 percent of the \$2.1 trillion it collects annually in taxes. Only 24 companies in the S&P 500 however incur interest payments that total at least 10 percent of their revenue.

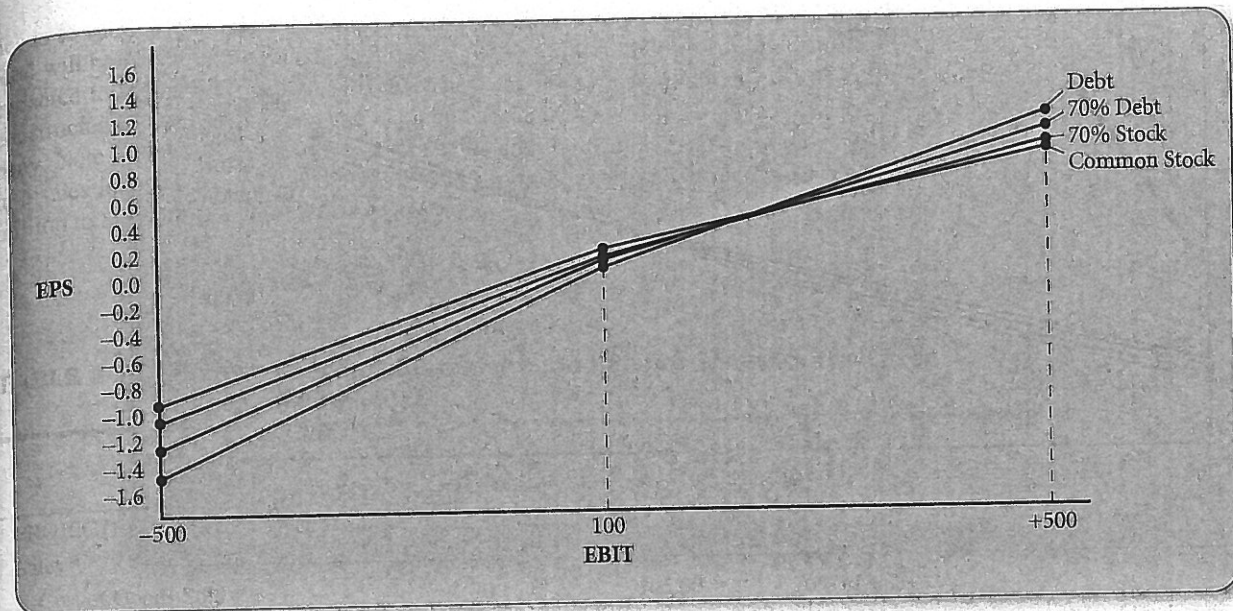
Tables 8-5 and 8-6 provide EPS/EBIT analyses for two companies—Gateway Computers and Boeing. Notice in those analyses that the combination stock/debt options vary from 30/70 to 70/30. Any number of combinations could be explored. However, sometimes in preparing the EPS/EBIT graphs, the lines will intersect, thus revealing break-even points at which one financing alternative becomes more or less attractive than another. The slope of these lines will be determined by a combination of factors including stock price, interest rate, number of shares, and amount of capital needed. Also, it should be noted here that the best financing alternatives are indicated by the highest EPS values. In Tables 8-5 and 8-6, note that the tax rates for the companies vary considerably and should be computed from the respective income statements by dividing taxes paid by income before taxes.

In Table 8-5, the higher EPS values indicate that Gateway should use stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Stock is the best alternative for Gateway under all three conditions if EAT (profit maximization) were the decision criteria, but EPS (maximize shareholders' wealth) is the better ratio to make this decision. Firms can do many things in the short run to maximize profits, so investors and creditors consider maximizing shareholders' wealth to be the better criteria for making financing decisions.

In Table 8-6, note that Boeing should use stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Let us calculate here the number of shares figure of 1014.68 given under Boeing's stock alternative. Divide \$10,000 M funds needed by the stock price of \$53 = 188.68 M new shares to be issued + the 826 M shares outstanding already = 1014.68 M shares under the stock scenario. Along the final row, EPS is the number of shares outstanding divided by EAT in all columns.

TABLE 8-5 EPS/EBIT Analysis for Gateway (M = in millions)

Amount Needed: \$1,000 M						
EBIT Range: - \$500 M to + \$100 M to + \$500 M						
Interest Rate: 5%						
Tax Rate: 0% (because the firm has been incurring a loss annually)						
Stock Price: \$6.00						
# of Shares Outstanding: 371 M						
	Common Stock Financing			Debt Financing		
	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	0.00	0.00	0.00	50.00	50.00	50.00
EBT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(500.00)	100.00	500.00	(550.00)	50.00	450.00
#Shares	537.67	537.67	537.67	371.00	371.00	371.00
EPS	(0.93)	0.19	0.93	(1.48)	0.13	1.21
	70 Percent Stock—30 Percent Debt			70 Percent Debt—30 Percent Stock		
	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>
EBIT	(500.00)	100.00	500.00	(500.00)	100.00	500.00
Interest	15.00	15.00	15.00	35.00	35.00	35.00
EBT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
Taxes	0.00	0.00	0.00	0.00	0.00	0.00
EAT	(515.00)	85.00	485.00	(535.00)	65.00	465.00
#Shares	487.67	487.67	487.67	421.00	421.00	421.00
EPS	(1.06)	0.17	0.99	(1.27)	0.15	1.10



Conclusion: Gateway should use common stock to raise capital in recession or normal economic conditions but should use debt financing under boom conditions. Note that stock is the best alternative under all three conditions according to EAT (profit maximization), but EPS (maximize shareholders' wealth) is the better ratio to make this decision.

TABLE 8-6 EPS/EBIT Analysis for Boeing (M = in millions)

Amount Needed: \$10,000 M

Interest Rate: 5%

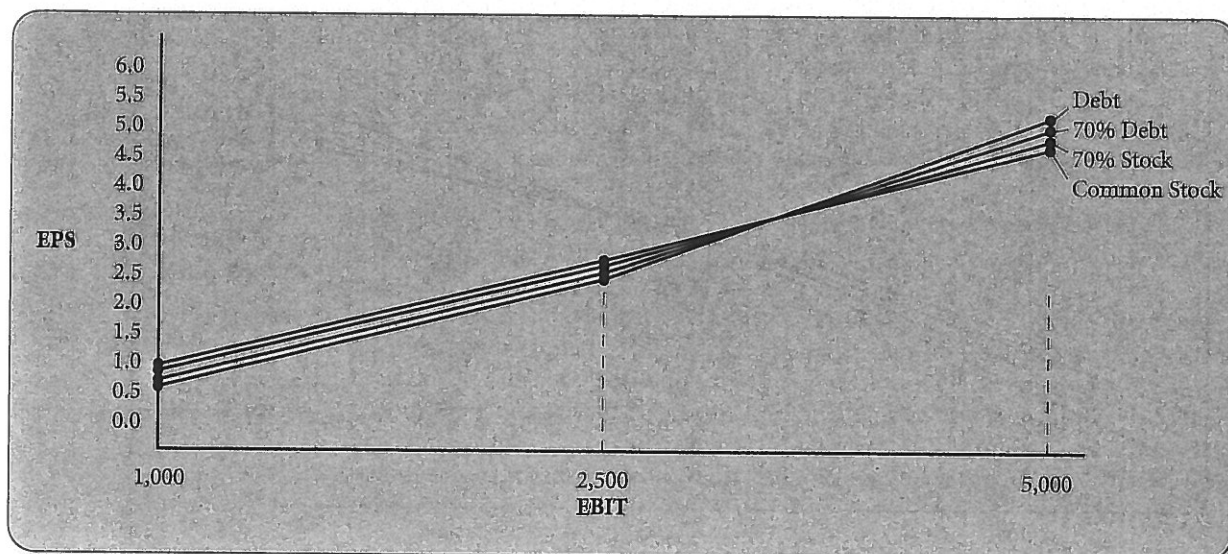
Tax Rate: 7%

Stock Price: \$53.00

of Shares Outstanding: 826 M

	Common Stock Financing			Debt Financing		
	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	0.00	0.00	0.00	500.00	500.00	500.00
EBT	1,000.00	2,500.00	5,000.00	500.00	2,000.00	4,500.00
Taxes	70.00	175.00	350.00	35.00	140.00	315.00
EAT	930.00	2,325.00	4,650.00	465.00	1,860.00	4,185.00
# Shares	1,014.68	1,014.68	1,014.68	826.00	826.00	826.00
EPS	0.92	2.29	4.58	0.56	2.25	5.07

	70% Stock—30% Debt			70% Debt—30% Stock		
	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>	<i>Recession</i>	<i>Normal</i>	<i>Boom</i>
EBIT	1,000.00	2,500.00	5,000.00	1,000.00	2,500.00	5,000.00
Interest	150.00	150.00	150.00	350.00	350.00	350.00
EBT	850.00	2,350.00	4,850.00	650.00	2,150.00	4,650.00
Taxes	59.50	164.50	339.50	45.50	150.50	325.50
EAT	790.50	2,185.50	4,510.50	604.50	1,999.50	4,324.50
# Shares	958.08	958.08	958.08	882.60	882.60	882.60
EPS	0.83	2.28	4.71	0.68	2.27	4.90



Conclusion: Boeing should use common stock to raise capital in recession (see 0.92) or normal (see 2.29) economic conditions but should use debt financing under boom conditions (see 5.07). Note that a dividends row is absent from this analysis. The more shares outstanding, the more dividends to be paid (if the firm pays dividends), which would lower the common stock EPS values.

Note in Table 8-5 and Table 8-6 that a dividends row is absent from both the Gateway and Boeing analyses. The more shares outstanding, the more dividends to be paid (if the firm indeed pays dividends). To consider dividends in an EPS/EBIT analysis, simply insert another row for “Dividends” right below the “EAT” row and then insert an “Earnings After Taxes and Dividends” row. Considering dividends would make the analysis more robust.

Note in both the Gateway and Boeing graphs, there is a breakeven point between the normal and boom range of EBIT where the debt option overtakes the 70/30 D/S option as the best financing alternative. A break-even point is where two lines cross each other. A break-even point is the EBIT level where various financing alternative represented by lines crossing are equally attractive in terms of EPS. Both the Gateway and Boeing graphs indicate that EPS values are highest for the 100 percent debt option at high EBIT levels. The two graphs also reveal that the EPS values for 100 percent debt increase faster than the other financing options as EBIT levels increase beyond the break-even point. At low levels of EBIT however, both the Gateway and Boeing graphs indicate that 100 percent stock is the best financing alternative because the EPS values are highest.

Projected Financial Statements

Projected financial statement analysis is a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementation decisions (for example, to increase promotion expenditures by 50 percent to support a market-development strategy, to increase salaries by 25 percent to support a market-penetration strategy, to increase research and development expenditures by 70 percent to support product development, or to sell \$1 million of common stock to raise capital for diversification). Nearly all financial institutions require at least three years of projected financial statements whenever a business seeks capital. A projected income statement and balance sheet allow an organization to compute projected financial ratios under various strategy-implementation scenarios. When compared to prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches.

Primarily as a result of the Sarbanes-Oxley Act, companies today are being much more diligent in preparing projected financial statements to “reasonably rather than too optimistically” project future expenses and earnings. There is much more care not to mislead shareholders and other constituencies.

A 2015 projected income statement and a balance sheet for the Litten Company are provided in Table 8-7. The projected statements for Litten are based on five assumptions: (1) The company

needs to raise \$45 million to finance expansion into foreign markets; (2) \$30 million of this total will be raised through increased debt and \$15 million through common stock; (3) sales are expected to increase 50 percent; (4) three new facilities, costing a total of \$30 million, will be constructed in foreign markets; and (5) land for the new facilities is already owned by the company. Note in Table 8-7 that Litten's strategies and their implementation are expected to result in a sales increase from \$100 million to \$150 million and in a net increase in income from \$6 million to \$9.75 million in the forecasted year.

TABLE 8-7 A Projected Income Statement and Balance Sheet for the Litten Company (in millions)

	Prior Year 2014	Projected Year 2015	Remarks
PROJECTED INCOME STATEMENT			
Sales	\$100	\$150.00	50% increase
Cost of Goods Sold	70	105.00	70% of sales
Gross Margin	30	45.00	
Selling Expense	10	15.00	10% of sales
Administrative Expense	5	7.50	5% of sales
Earnings Before Interest and Taxes	15	22.50	
Interest	3	3.00	
Earnings Before Taxes	12	19.50	
Taxes	6	9.75	50% rate
Net Income	6	9.75	
Dividends	2	5.00	
Retained Earnings	4	4.75	
PROJECTED BALANCE SHEET			
Assets			
Cash	5	7.75	Plug figure
Accounts Receivable	2	4.00	100% increase
Inventory	20	45.00	
Total Current Assets	27	56.75	
Land	15	15.00	
Plant and Equipment	50	80.00	Add three new plants at \$10 million each
Less Depreciation	10	20.00	
Net Plant and Equipment	40	60.00	
Total Fixed Assets	55	75.00	
Total Assets	82	131.75	
Liabilities			
Accounts Payable	10	10.00	
Notes Payable	10	10.00	
Total Current Liabilities	20	20.00	
Long-term Debt	40	70.00	Borrowed \$30 million
Additional Paid-in-Capital	20	35.00	Issued 100,000 shares at \$150 each
Retained Earnings	2	6.75	\$2 + \$4.75
Total Liabilities and Net Worth	82	131.75	

There are six steps in performing projected financial analysis:

1. Prepare the projected income statement before the balance sheet. Start by forecasting sales as accurately as possible. Be careful not to blindly push historical percentages into the future with regard to revenue (sales) increases. Be mindful of what the firm did to achieve those past sales increases, which may not be appropriate for the future unless the firm takes similar or analogous actions (such as opening a similar number of stores, for example). If dealing with a manufacturing firm, also be mindful that if the firm is operating at 100 percent capacity running three eight-hour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.
2. Use the percentage-of-sales method to project cost of goods sold (CGS) and the expense items in the income statement. For example, if CGS is 70 percent of sales in the prior year (as it is in Table 8-7), then use that same percentage to calculate CGS in the future year—unless there is a reason to use a different percentage. Items such as interest, dividends, and taxes must be treated independently and cannot be forecasted using the percentage-of-sales method.
3. Calculate the projected net income.
4. Subtract from the net income any dividends to be paid for that year. This remaining net income is retained earnings (RE). Bring this retained earnings amount for that year ($NI - DIV = RE$) over to the balance sheet by adding it to the prior year's RE shown on the balance sheet. In other words, every year a firm adds its RE for that particular year (from the income statement) to its historical RE total on the balance sheet. Therefore, the RE amount on the balance sheet is a cumulative number rather than money available for strategy implementation! Note that RE is the first projected balance sheet item to be entered. As a result of this accounting procedure in developing projected financial statements, the RE amount on the balance sheet is usually a large number. However, it also can be a low or even negative number if the firm has been incurring losses. The only way for RE to decrease from one year to the next on the balance sheet is (1) if the firm incurred an earnings loss that year or (2) the firm had positive net income for the year but paid out dividends more than the net income. Be mindful that RE is the key link between a projected income statement and balance sheet, so be careful to make this calculation correctly.
5. Project the balance sheet items, beginning with retained earnings and then forecasting stockholders' equity, long-term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets (in that order). Use the cash account as the plug figure—that is, use the cash account to make the assets total the liabilities and net worth. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), make appropriate changes to borrow more (or less) money than planned.
6. List comments (remarks) on the projected statements. Any time a significant change is made in an item from a prior year to the projected year, an explanation (remark) should be provided. Remarks are essential because otherwise pro formas are meaningless.

Projected Financial Statement Analysis for Whole Foods Market

Because so many strategic management students have limited experience developing projected financial statements, let us apply the steps outlined on the previous pages to Whole Foods Market.

Whole Foods Market opened 16 stores in fiscal 2010. The projected statements given on the next page(s) are based on the following recommendations:

1. Whole Foods opens 40 new stores in 2011 and 60 new stores in 2012.
2. Whole Foods uses a 50/50 debt/stock combination to finance the 100 new stores.
3. After paying almost no dividends in 2010, Whole Foods starts paying dividends at \$1.00 per share in 2011 and 2012.
4. Whole Foods boosts its advertising expenses by \$20 million per year.
5. Whole Foods installs a new inventory control system that increases the company's low gross margin from 34.8 percent to 40.0 percent.
6. Whole Foods' per store revenues will increase 10 percent annually in 2011–2013 resulting from the new ad campaign and the improving economy.
7. Total cost of recommendations for two years are \$800 million = \$200 million per year to be raised through both debt and equity.

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Whole Foods' actual consolidated income statements and balance sheets are provided in Table 8-8 and Table 8-9, respectively. The projected statements, based on the aforementioned recommendations, are provided in Table 8-10 and 8-11, respectively. Read carefully the notes (a through f), which reveal the rationale for various changes and exemplify the pro forma process. Note in Table 8-10 that Whole Foods' operating margin with the proposed strategic plan increases from 4.9 percent in 2010 to 16.9 percent in 2012. Note in Table 8-11 that Whole Foods' current ratio would be $\$3,580.3/\$400 = 8.95$, which is high. Thus, in 2012 the company could better use that money to perhaps pay down some of its \$908 million in long-term debt.

The projected financial statements were prepared using the six steps outlined on prior pages and the above seven strategy statements. Note the cash account is used as the plug figure, and it is too high, so Whole Foods could reduce this number and concurrently reduce a liability or equity account the same amount to keep the statement in balance. Rarely is the cash account perfect on the first pass through, so adjustments are needed and made. However, these adjustments are *not* made on the projected statements given in Tables 8-10 and 8-11, so that the five strategy statements can be more readily seen on respective rows. Note the author's comments on Tables 8-10 and 8-11 that help explain changes in the numbers.

The U.S. Securities and Exchange Commission (SEC) conducts fraud investigations if projected numbers are misleading or if they omit information that's important to investors. Projected statements must conform with generally accepted accounting principles (GAAP) and must not be designed to hide poor expected results. The Sarbanes-Oxley Act requires CEOs and CFOs of corporations to personally sign their firms' financial statements attesting to their accuracy. These executives could thus be held personally liable for misleading or inaccurate statements. The collapse of the Arthur Andersen accounting firm, along with its client Enron, fostered a "zero-tolerance" policy among auditors and shareholders with regard to a firm's financial statements. But plenty of firms still "inflate" their financial projections and call them "pro formas," so investors, shareholders, and other stakeholders must still be wary of different companies' financial projections.⁹

On financial statements, different companies use different terms for various items, such as *revenues* or *sales* used for the same item by different companies. For net income, many firms use the term *earnings*, and many others use the term *profits*.

Financial Budgets

A **financial budget** is a document that details how funds will be obtained and spent for a specified period of time. Annual budgets are most common, although the period of time for a budget can range from one day to more than 10 years. Fundamentally, financial budgeting is a method

TABLE 8-8 Actual Whole Foods Market Income Statements (in millions)

	2010	2009
Revenue (a)	\$9,005.8	\$8,031.6
Cost of Goods Sold	5,870.4	5,277.3
Gross Profit	3,135.4	2,754.3
Gross Profit Margin	34.8%	34.3%
SG&A Expense	2,697.4	2,470.0
Depreciation & Amortization	275.6	266.7
Operating Income	438.0	284.3
Operating Margin	4.9%	3.5%
Nonoperating Income	6.9	3.4
Nonoperating Expenses	(33.0)	(36.9)
Income Before Taxes	411.8	250.9
Income Taxes (b)	165.9	104.1
Net Income After Taxes	245.8	146.8
Net Income	\$245.8	\$146.8

(a) Note that the 16 news stores in 2010 resulted in $(\$9,005.8 - \$8,031.6) = \$974.2$ revenue increase = an average of $\$974.2 / 16 = \60.89 \$60.89 million as the average revenue per new store.

(b) Note Whole Foods' effective tax rate is $\$165.9 / \$411.8 = 40.3\%$.

TABLE 8-9 Actual Whole Foods Market Balance Sheets (in millions)

	2010	2009
Assets		
Current Assets		
Cash	\$132.0	\$430.1
Net Receivables	133.3	104.7
Inventories	323.5	310.6
Other Current Assets	572.7	209.9
Total Current Assets	1,161.5	1,055.4
Net Fixed Assets (a)	1,886.1	1,897.9
Other Noncurrent Assets	938.9	830.2
Total Assets	3,986.5	3,783.4
Liabilities		
Current Liabilities		
Accounts Payable	213.2	189.6
Short-Term Debt	0.4	0.4
Other Current Liabilities	534.3	494.0
Total Current Liabilities	747.9	684.0
Long-Term Debt	508.3	738.8
Other Noncurrent Liabilities	357.0	732.6
Total Liabilities	1,613.2	2,155.5
Shareholders' Equity		
Common Stock	500	400
Additional-paid-in-capital	1,274.7	869.7
Retained Earnings (b)	598.6	358.2
Total Shareholders' Equity	2,373.3	1,627.9
Total Liabilities and SE	\$3,986.5	\$3,783.4
Shares Outstanding (thou.)	172,033	140,542

(a) Since Whole Foods operated 300 stores in 2010, we can estimate cost per store = $\$1,886 / 300 = \6.3 million and use that cost # for each new store to be built.

(b) Note that Whole Foods reinvested back into the company \$240.4 million of its total \$245.8 million in net income, so in 2010 the company paid out only \$5.4 million in dividends. We know that because $\$598.6 - \$358.2 = \$240.4$.

for specifying what must be done to complete strategy implementation successfully. Financial budgeting should not be thought of as a tool for limiting expenditures but rather as a method for obtaining the most productive and profitable use of an organization's resources. Financial budgets can be viewed as the planned allocation of a firm's resources based on forecasts of the future.

There are almost as many different types of financial budgets as there are types of organizations. Some common types of budgets include cash budgets, operating budgets, sales budgets, profit budgets, factory budgets, capital budgets, expense budgets, divisional budgets, variable budgets, flexible budgets, and fixed budgets. When an organization is experiencing financial difficulties, budgets are especially important in guiding strategy implementation.

Perhaps the most common type of financial budget is the **cash budget**. The Financial Accounting Standards Board (FASB) has mandated that every publicly held company in the USA must issue an annual cash-flow statement in addition to the usual financial reports. The statement includes all receipts and disbursements of cash in operations, investments, and financing. It supplements the Statement on Changes in Financial Position formerly included in the annual reports of all publicly held companies. A cash budget for the year 2015 for the Toddler Toy Company is provided in Table 8-12. Note that Toddler is not expecting to have surplus cash until November 2015.