



Analyzing Growth Drivers & Business Risks

Course Instructor



Kyle Peterdy

VP, Commercial Banking & Credit

About Kyle...

Kyle's background is in commercial lending, where he was responsible for originating and underwriting middle market credit transactions. He has extensive experience conducting financial analysis and assessing business and industry risks. Kyle has a BEd from McGill University (Montreal, QC) and an MBA from the Sauder School of Business at the University of British Columbia (Vancouver, BC). Kyle is passionate about business strategy and risk management.

Learning Objectives



Define key categories of growth drivers and business risks



Compare different business analysis frameworks



Define how economic, industry and company-level characteristics influence business strategies & outcomes



Interpret the results of qualitative assessments



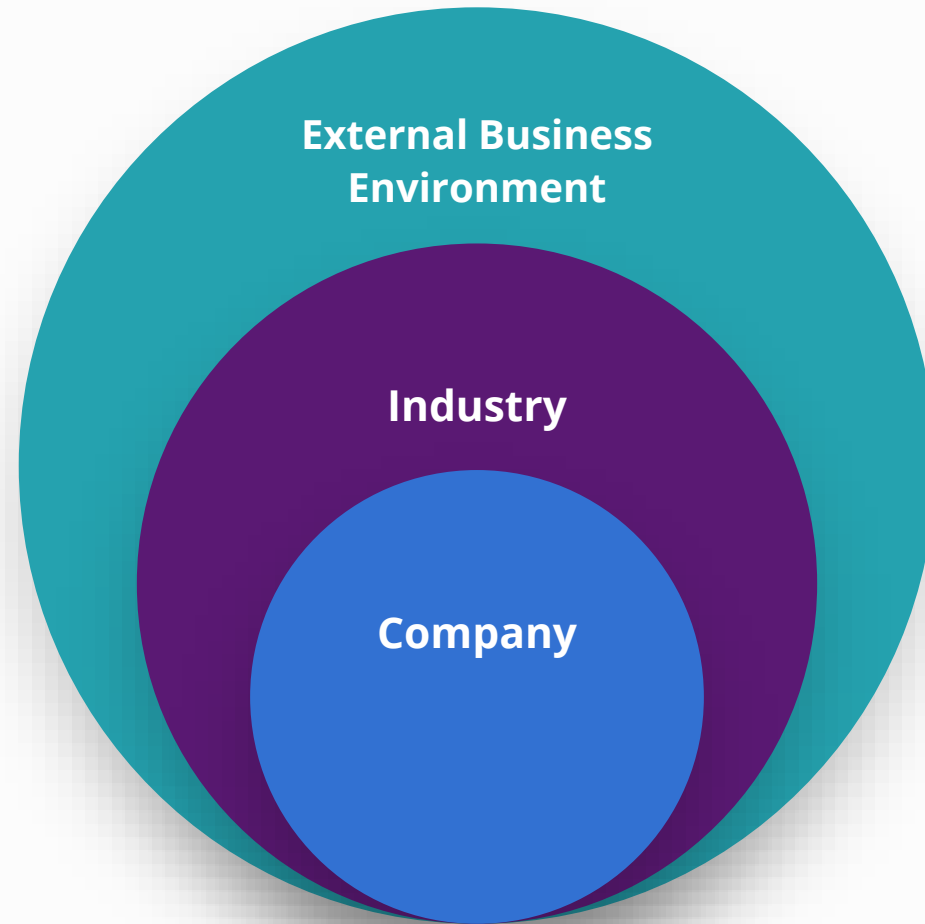
Explain how these results may inform financial analysis

Analyzing the External Business Environment

Analysis Framework

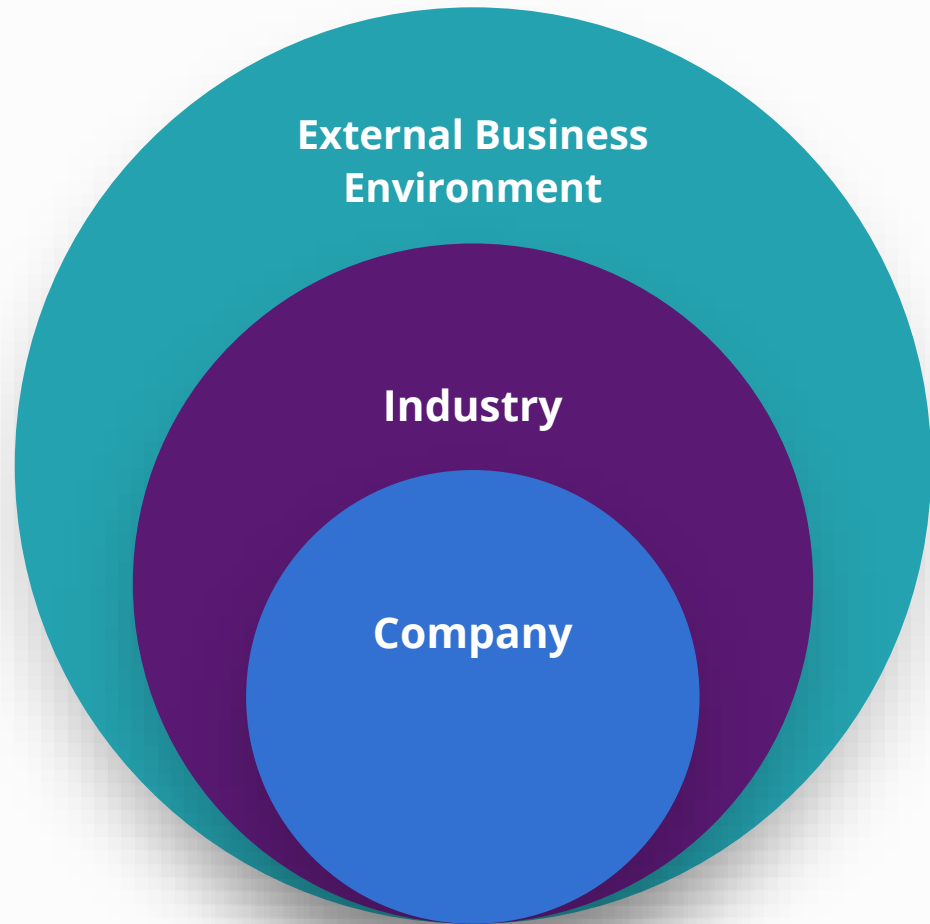
A business operates within an industry, which fits into the broader economy:

Top-down Approach



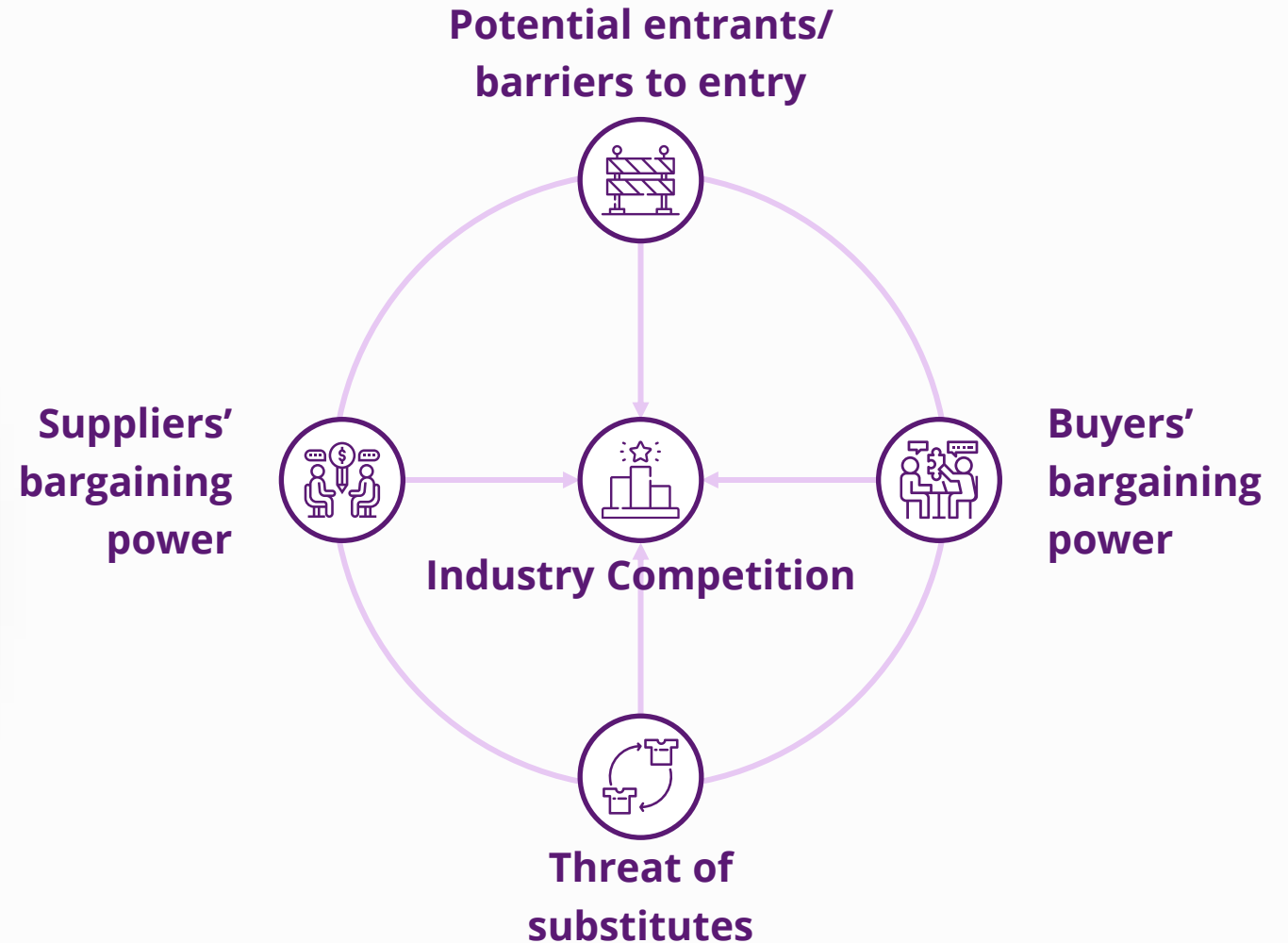
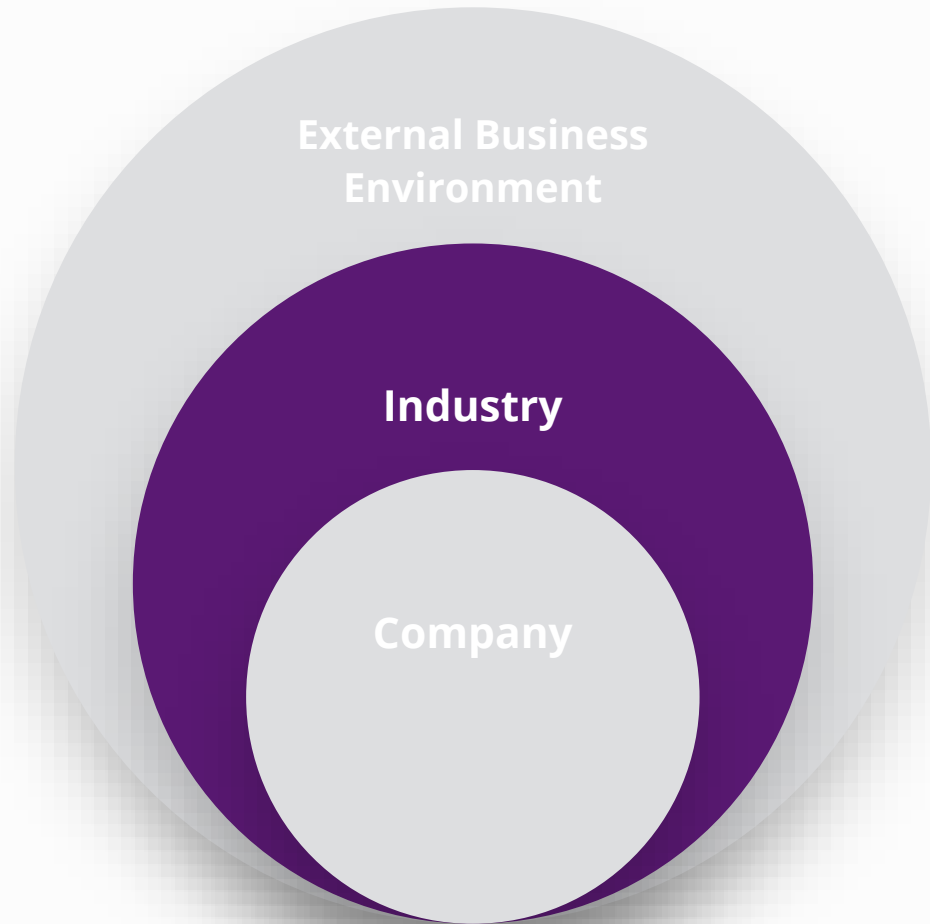
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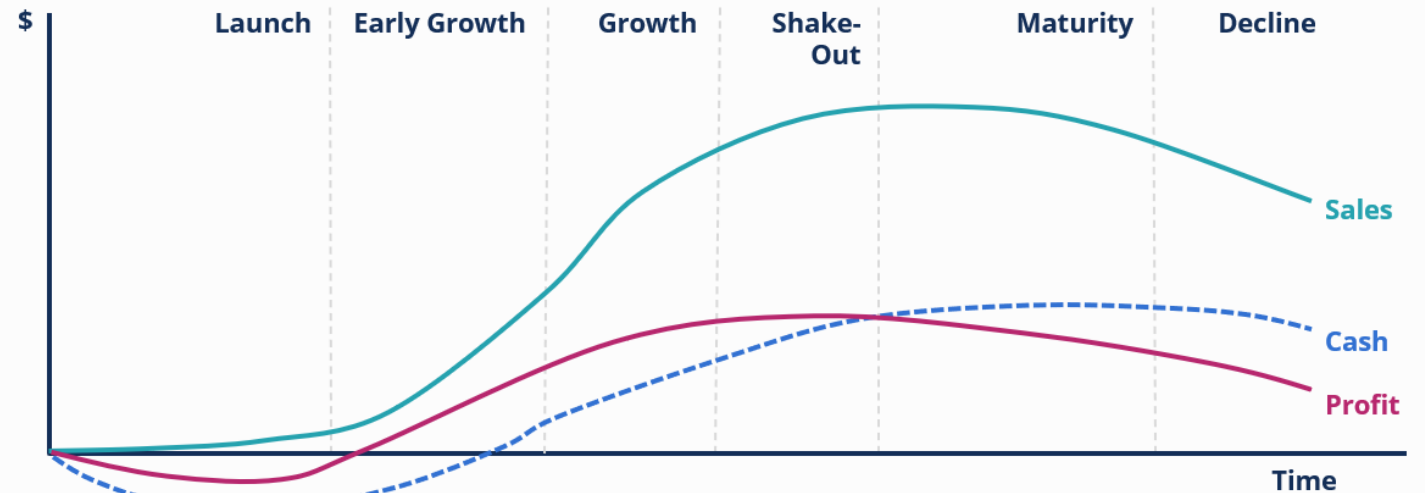
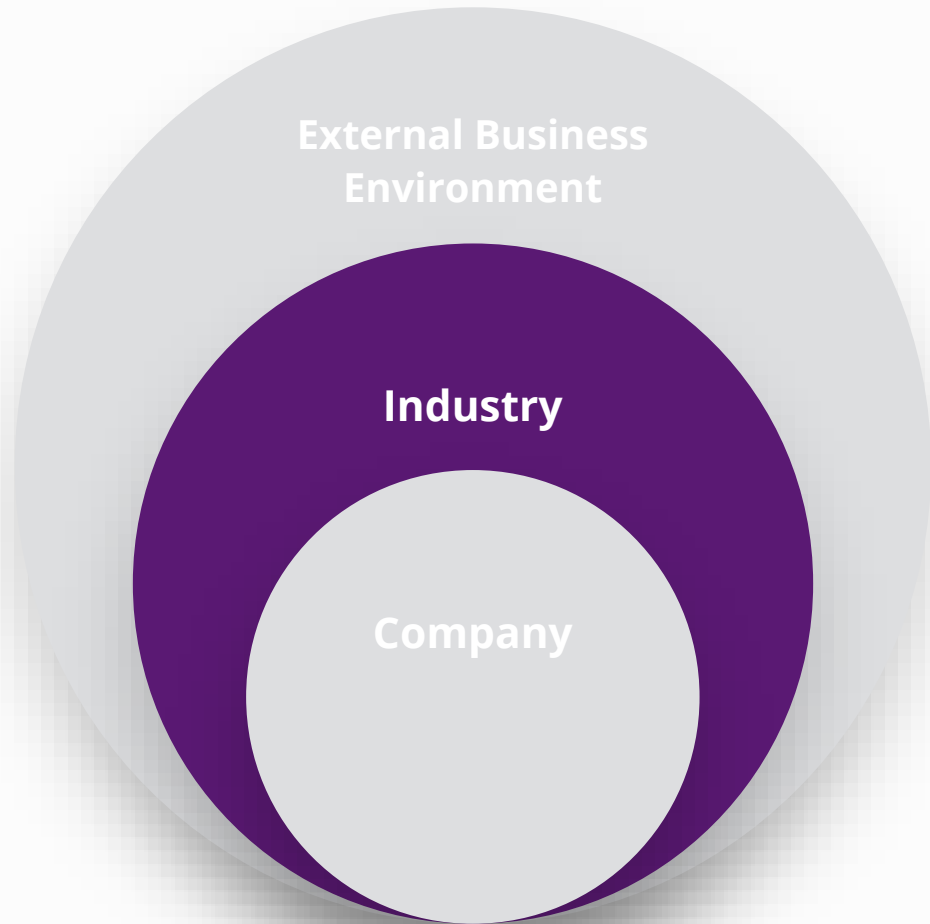
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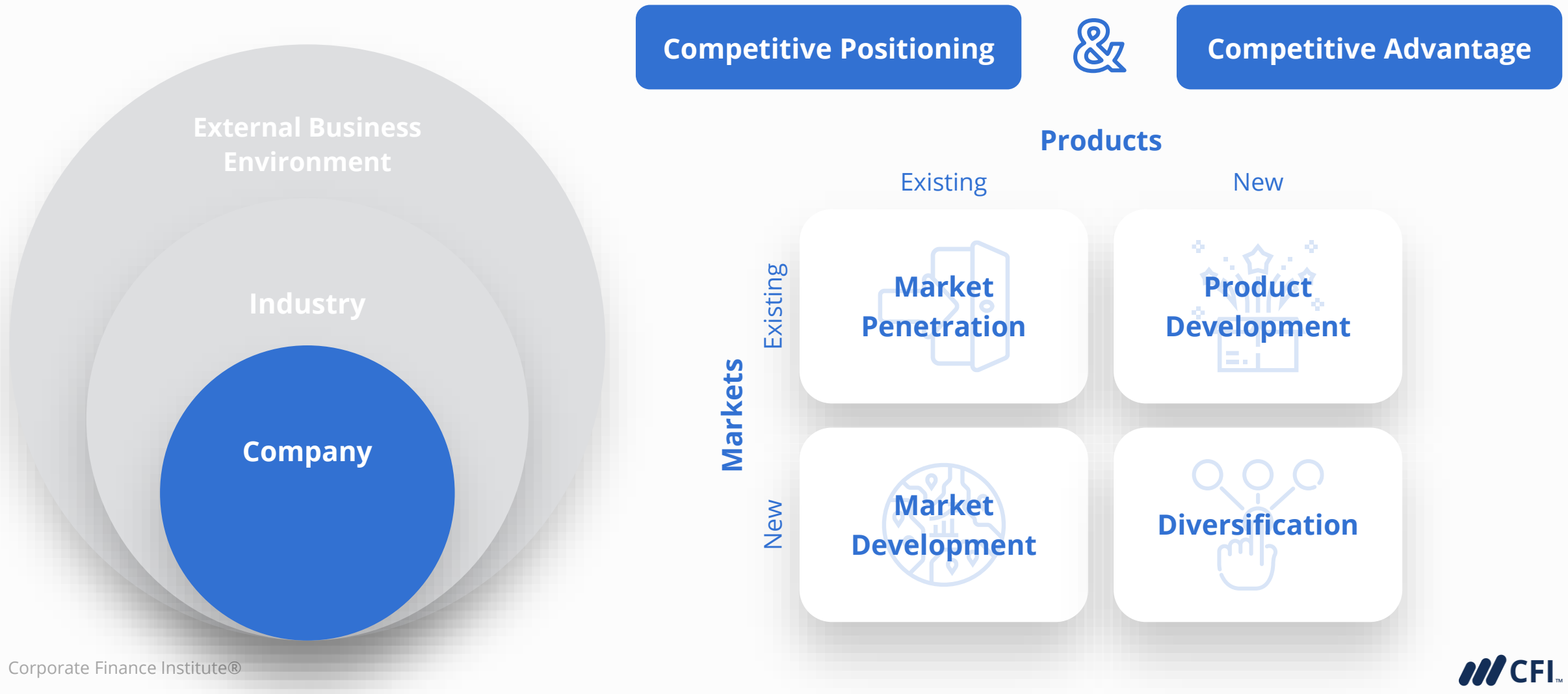
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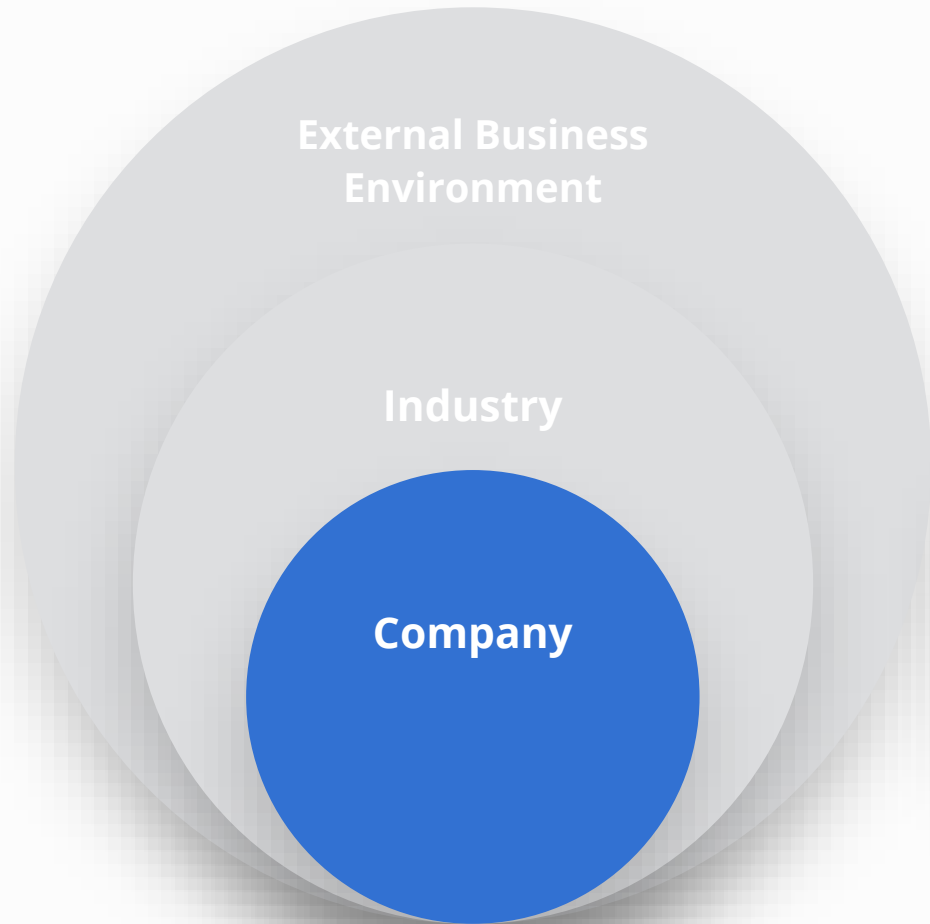
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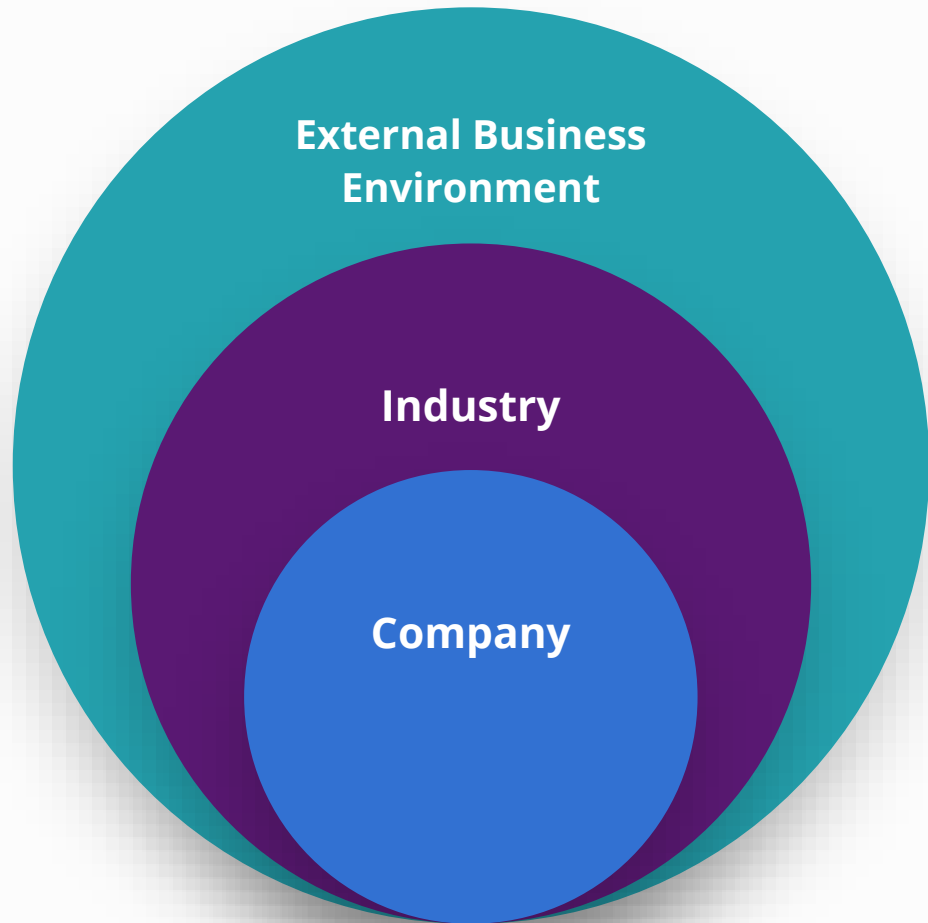
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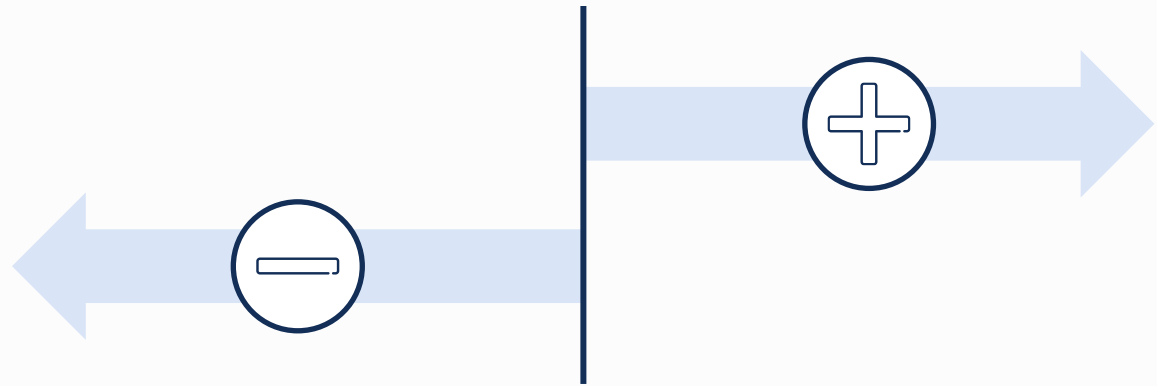


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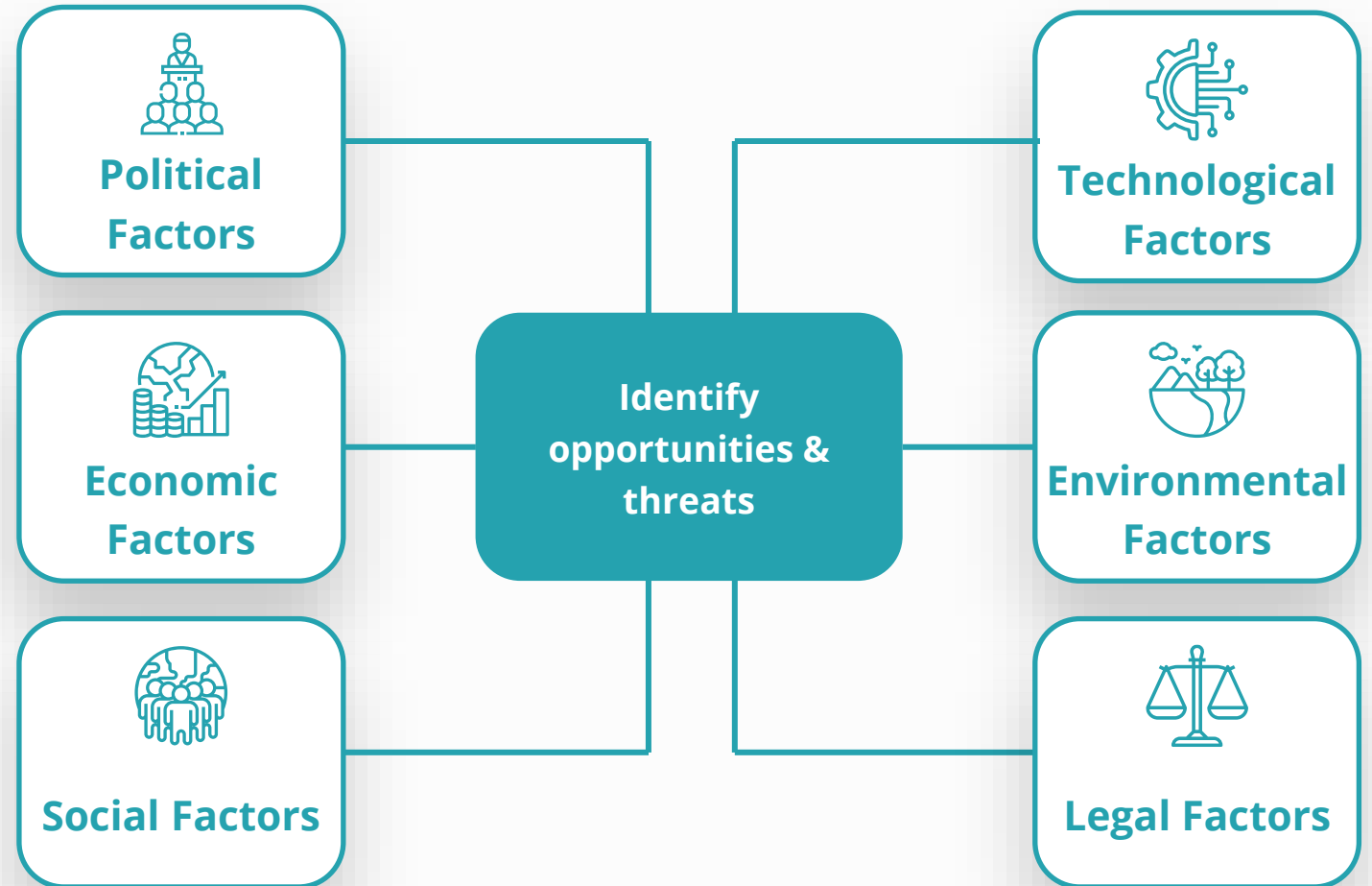
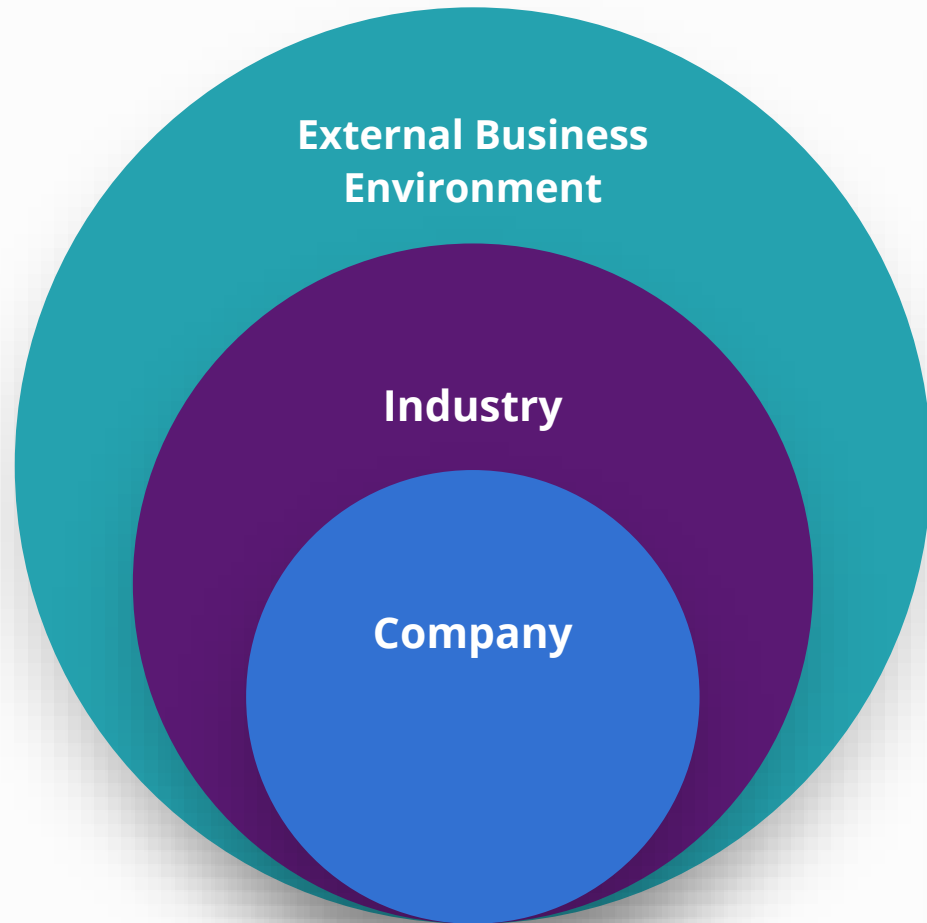
Understanding all three layers helps assess the company's growth opportunities, as well as what kinds of headwinds it might be facing.



Taking a comprehensive approach is important to recognize the positive and negative forces impacting the current state.

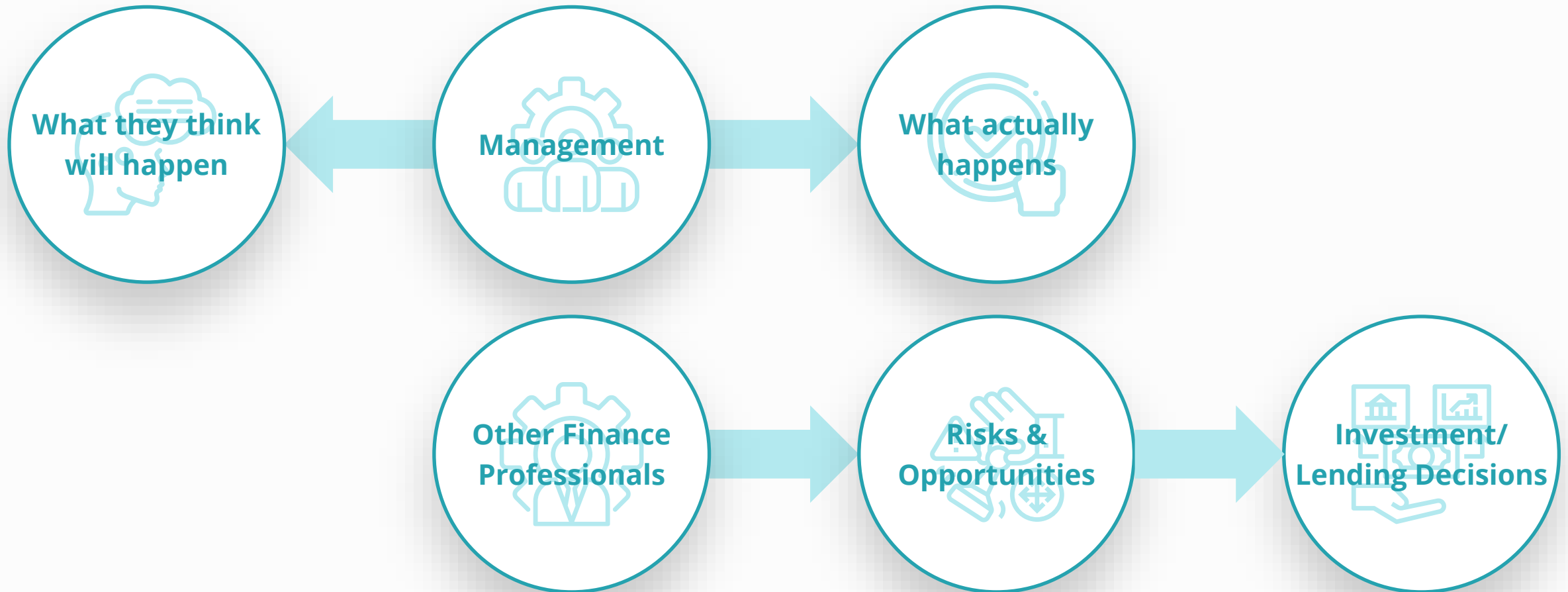
PESTEL Analysis

PESTEL analysis is a tool used to assess the macro-environment that a business operates in.



PESTEL Analysis

PESTEL analysis is used in corporate strategic planning to identify the pros and cons of the company's potential strategic initiatives.



PESTEL Analysis



Political Factors

Can have a serious impact on industries & individual businesses. They include:



Government Policies

Fiscal Policies



Taxation



Gov. Spending

PESTEL Analysis



Political Factors

Can have a serious impact on industries & individual businesses. They include:



**Government
Policies**



**Corporate
Tax Rates**

Corporate taxes are a huge consideration for management teams & analysts.

PESTEL Analysis



Political Factors

Can have a serious impact on industries & individual businesses. They include:



**Government
Policies**



**Corporate
Tax Rates**



**Government/
Business Relations**

These relations can influence the level of innovation-related initiatives and the nature of funding and grants that may be available.



This influence is particularly visible during election periods, which can be unsettling for financial markets.

Initiatives that encourage
taxation & spending



Policy initiatives that favor
businesses

PESTEL Analysis



Political Factors

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**Government
Policies**



**Corporate
Tax Rates**



**Government/
Business Relations**



**Competition &
Antitrust**



**Regulation Around
Patent Protection**



**Level of Consolidation
Within Industries**



**Concerns for
Management**



Views on industry competition are often influenced by political undercurrents.

PESTEL Analysis



Political Factors

Can have a serious impact on industries & individual businesses. They include:



**Government
Policies**



**Corporate
Tax Rates**



**Government/
Business Relations**



**Competition &
Antitrust**



**Global Trade
Relations**

Renegotiation of NAFTA- now USMCA.



Risks



Businesses



Opportunities

PESTEL Analysis



Economic Factors

Monetary policy is a big driver of these quantitative factors.

Monetary policy helps control the money supply.



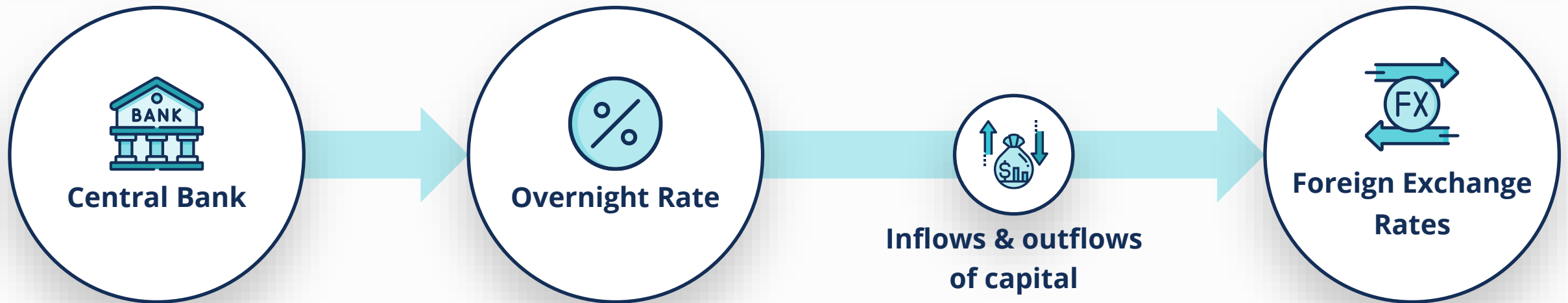
PESTEL Analysis



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PESTEL Analysis

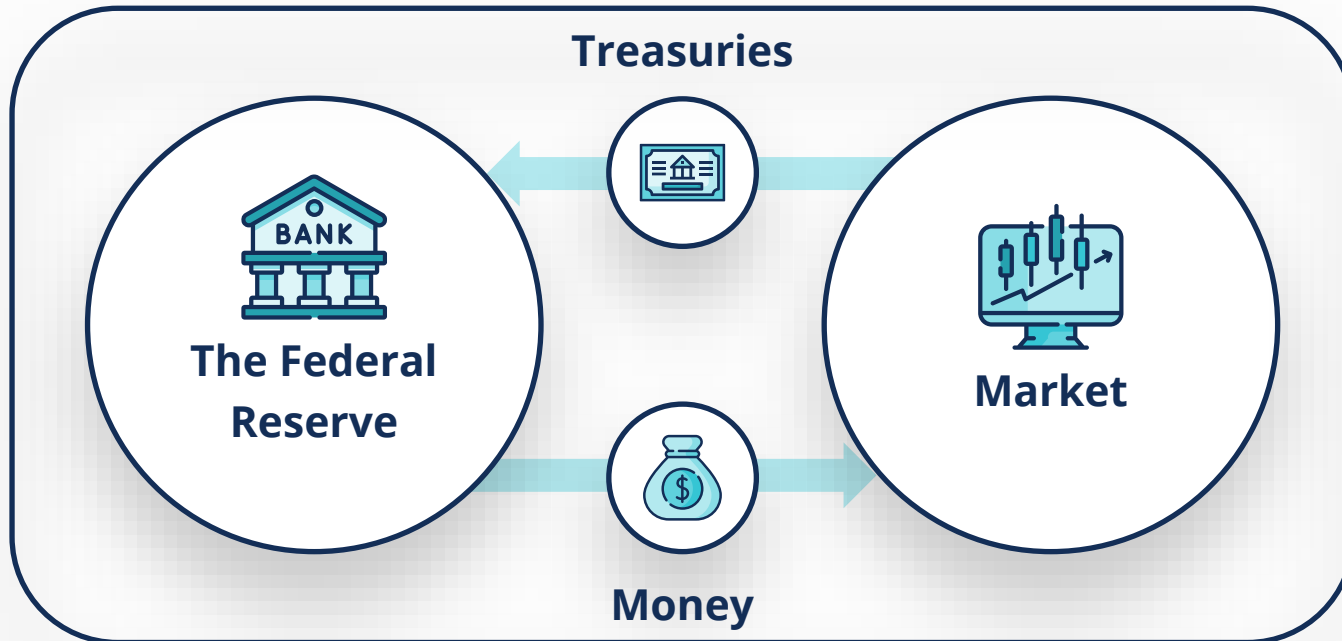


Economic Factors

Monetary policy is a big driver of these quantitative factors.

In the US, the sale (and purchase) of US treasuries also affects money supply.

Quantitative Easing



Increased money supply can cause an economy to “run hot”, which can lead to inflation, and in turn, increased interest rates.

PESTEL Analysis



Economic Factors

Monetary policy is a big driver of these quantitative factors.

The current phase of the economic cycle and employment rates are also economic factors.

PESTEL Analysis



Social Factors

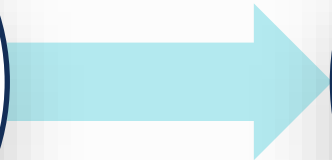
Can have a significant impact on businesses & industries.



Consumer Beliefs & Values



Healthy Lifestyle Trend



Healthier Food Groups



Change in food packaging & presentation of nutritional info



Greater transparency around ingredient sources

PESTEL Analysis



Social Factors

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Consumer Beliefs & Values



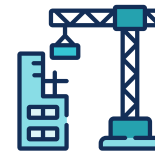
Demographic Trends



Smaller
Average Family
Size



Mass Migration
Towards Urban
Areas



Changes to Real
Estate
Development

Mixed use
commercial &
residential towers

PESTEL Analysis



Social Factors

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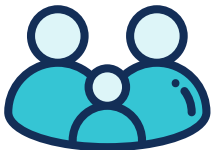
Consumer Beliefs & Values



Demographic Trends



Consumer Needs & Wants



Consumers



Convenience



Food Delivery
Apps



PESTEL Analysis



Technological Factors

Can be “game-changers” for a business, its industry, and the broader economy. They include:



Research & Development Spend



Where is the R&D spend relative to the company’s industry peer group?



How does this innovation affect projections and margins?



How intensive is R&D spend by a business’ direct competitors?

PESTEL Analysis



Technological Factors

Can be “game-changers” for a business, its industry, and the broader economy.
They include:



**Research & Development
Spend**



**Technological
Developments**



How can blockchain technology affect the company?



Will the evolution of the Metaverse serve as a disruptive force in the industry?

PESTEL Analysis



Technological Factors

Can be “game-changers” for a business, its industry, and the broader economy.
They include:



**Research & Development
Spend**



**Technological
Developments**



**Technological
Infrastructure**



**Internet of Things
(IoT)**



5G



**Cybersecurity
Attacks**



PESTEL Analysis



Technological Factors

Can be “game-changers” for a business, its industry, and the broader economy.
They include:



**Research & Development
Spend**



**Technological
Developments**



**Technological
Infrastructure**



Automation



**Improve margins by
eliminating
headcount**



**Devastating for
communities if it
results in mass
layoffs**

PESTEL Analysis



Environmental Factors

A newer addition, but one that is essential in today's ESG-centric business climate. The factors include:



Climate Change



Physical Risks



Transitional Risks



Stewardship of natural resources



Company's carbon footprint

The clear disclosure and management of both are increasingly becoming a focus of management teams and boards.

PESTEL Analysis



Environmental Factors

A newer addition, but one that is essential in today's ESG-centric business climate. The factors include:



Climate Change



Supply Chain

A firm's direct operations might be sheltered from climate risks; however, their suppliers might be impacted by environmental risks which could turn into business risks for the firm.

PESTEL Analysis

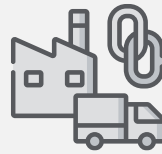


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Climate Change



Supply Chain



ESG Framework

The evolution of ESG has changed the way operators & analysts look at sustainability and has helped to create a more comprehensive analysis process.

PESTEL Analysis



Legal Factors

Risks and opportunities that can impact business operations.



Labor Standards

PESTEL Analysis



Legal Factors

Risks and opportunities that can impact business operations.



Labor Standards



Licensing & Permitting
Requirements



New Entrant

Licensing & Permitting
Requirements



Incumbent

PESTEL Analysis



Legal Factors

Risks and opportunities that can impact business operations.



Labor Standards



**Licensing & Permitting
Requirements**



**Reporting Requirements
for Public Companies**



**Reporting
requirements by
stock markets**



**ESG disclosure
requirements by
governments &
stock markets**

PESTEL Analysis



Legal Factors

Risks and opportunities that can impact business operations.



Labor Standards



Licensing & Permitting
Requirements



Reporting Requirements
for Public Companies



Intellectual Property (IP)

Who owns the IP?



Private
Enterprises



Covid Vaccine



Governments

PESTEL Analysis Example

Grocery Store- small regional chain

Political Factors

- Trade policies and their impact on imports/exports of produce & dairy.
- Available government grants & tax incentives.

Economic Factors

- Changes in household incomes, transportation costs, interest rates, inflation, and the general economic environment all impact the business.

Social Factors

- Demographic trends of smaller families.
- Consumer habits and sustainability.
- Health trends and evolving consumer demands.

Technological Factors

- Increasing online grocery shopping.
- Automated inventory management.
- Protecting consumer data.

Environmental Factors

- High carbon footprint & potential food waste present both a financial & reputational risk.
- Susceptibility to extreme weather events.

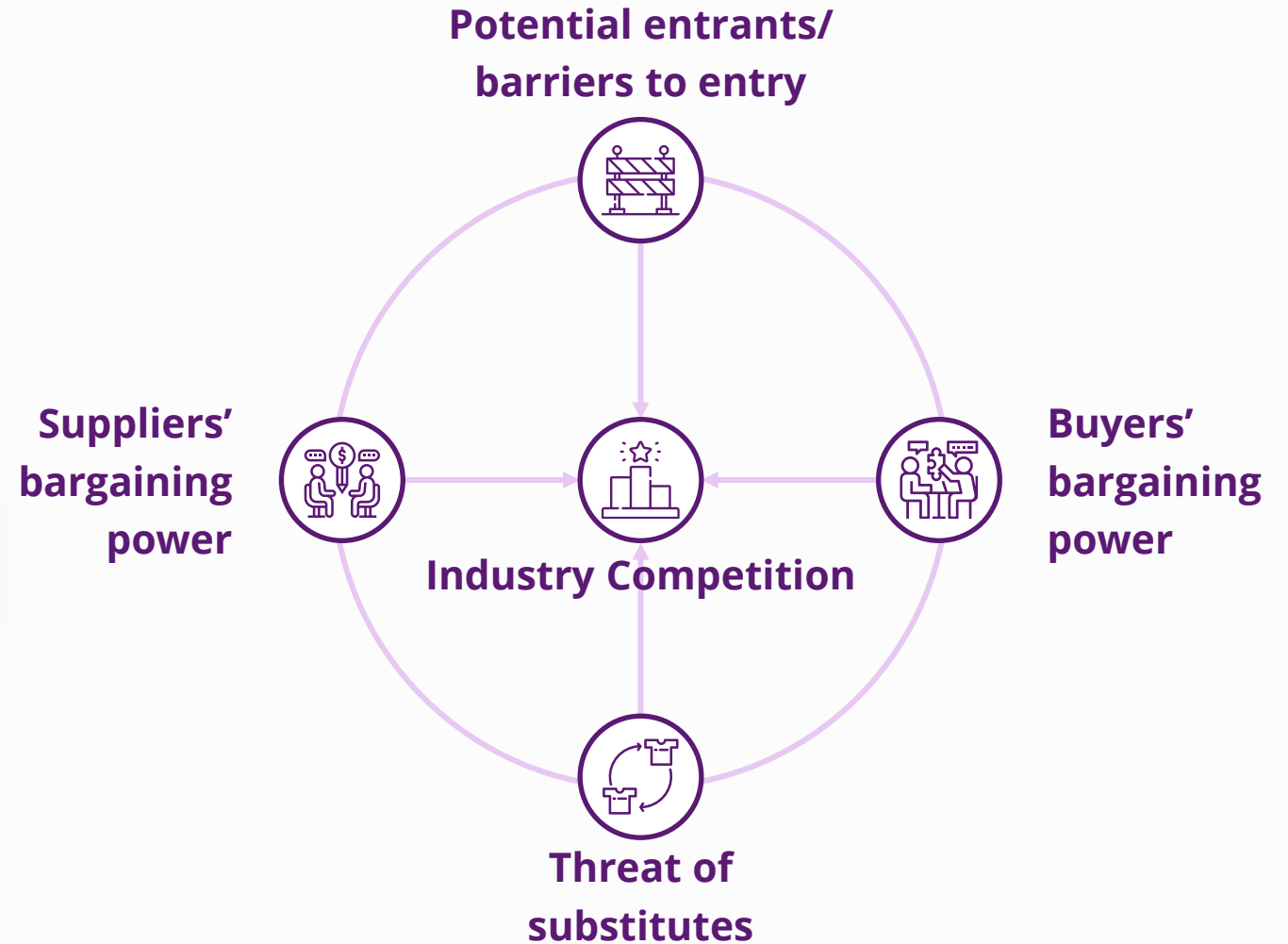
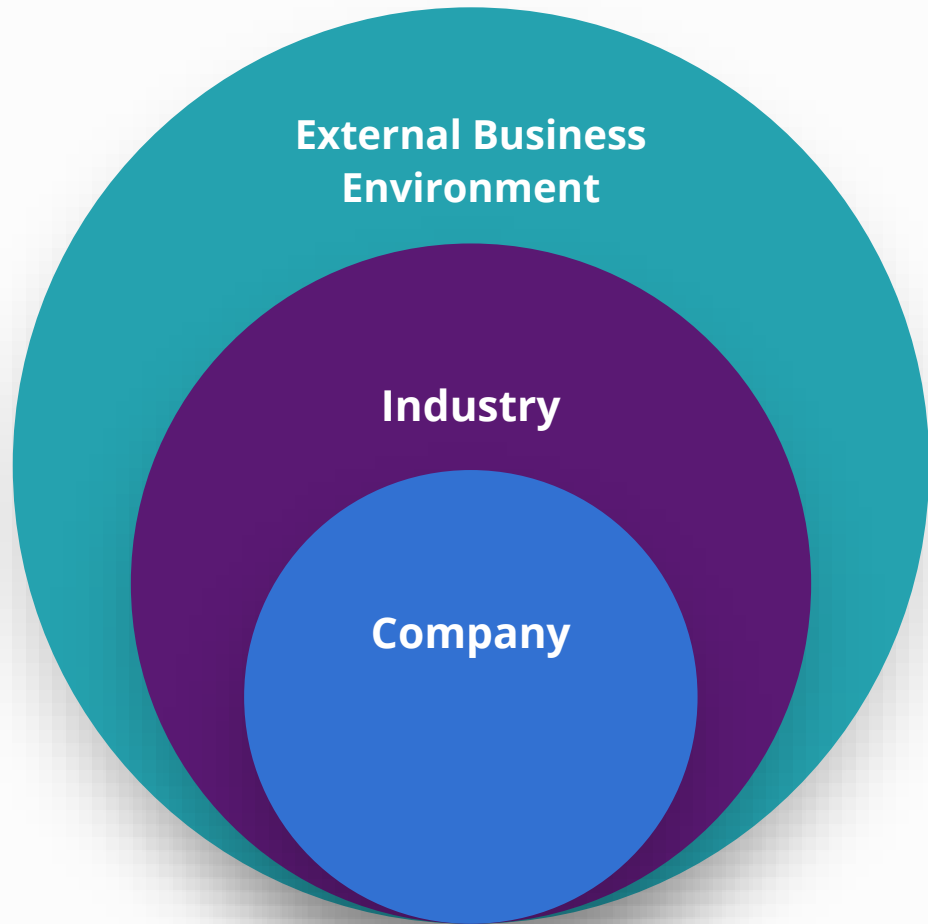
Legal Factors

- Changes in consumer safety policies.
- Changing regulations around operations and labor standards.

Analyzing the Industry

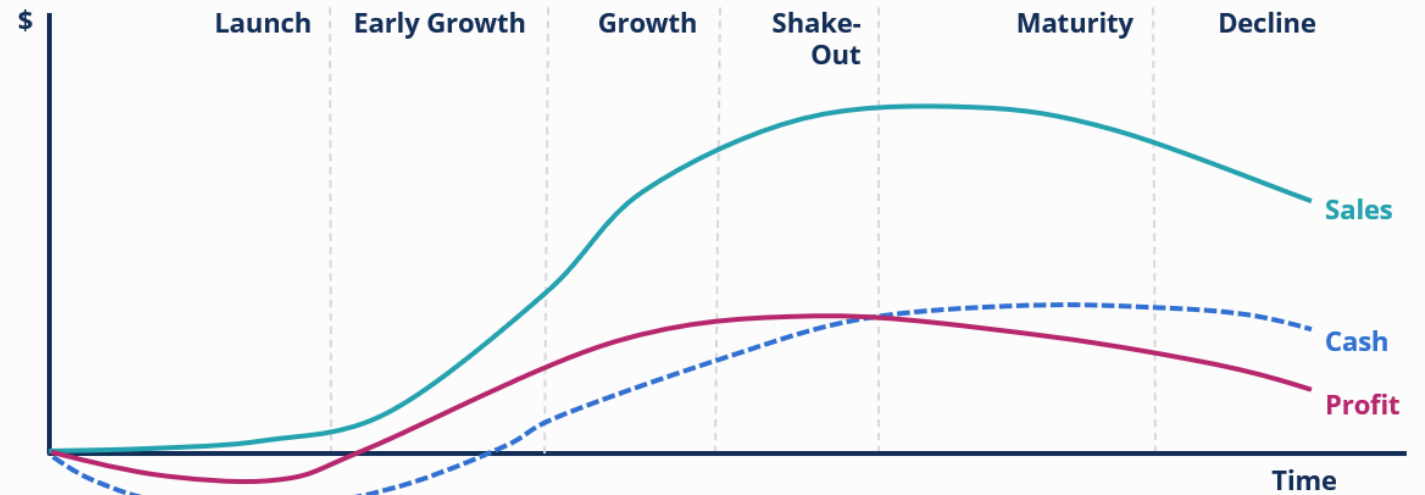
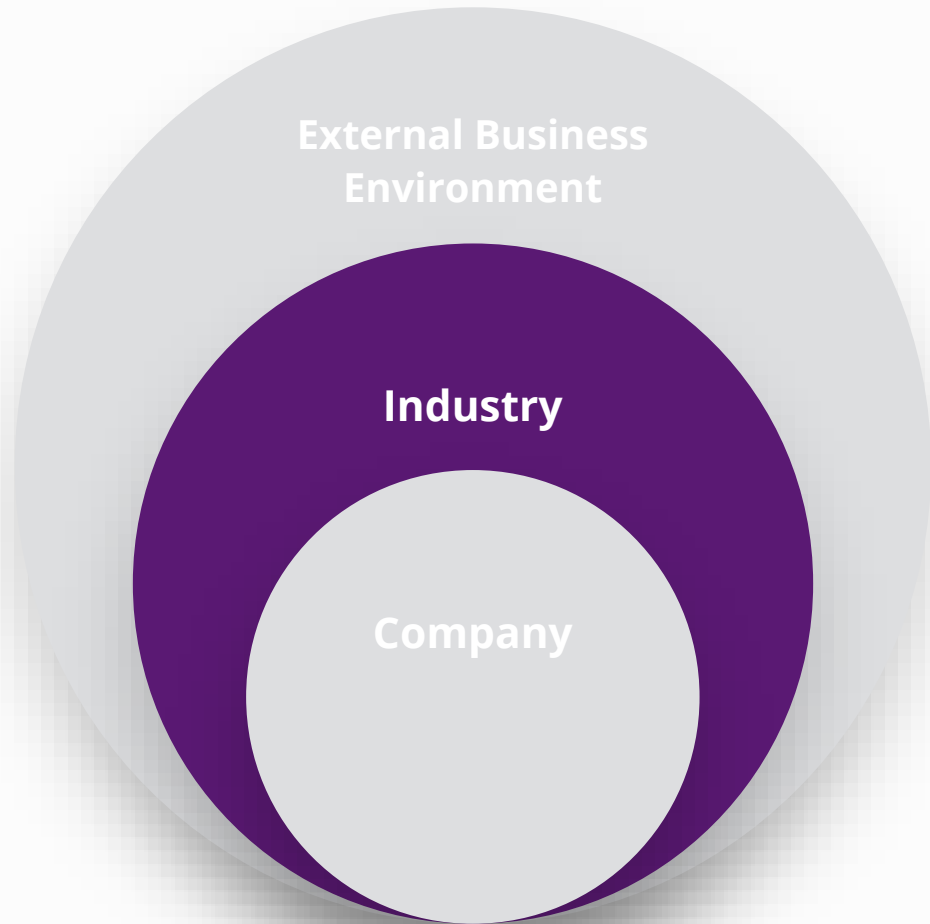
Analysis Framework

Frameworks to analyze industries include:



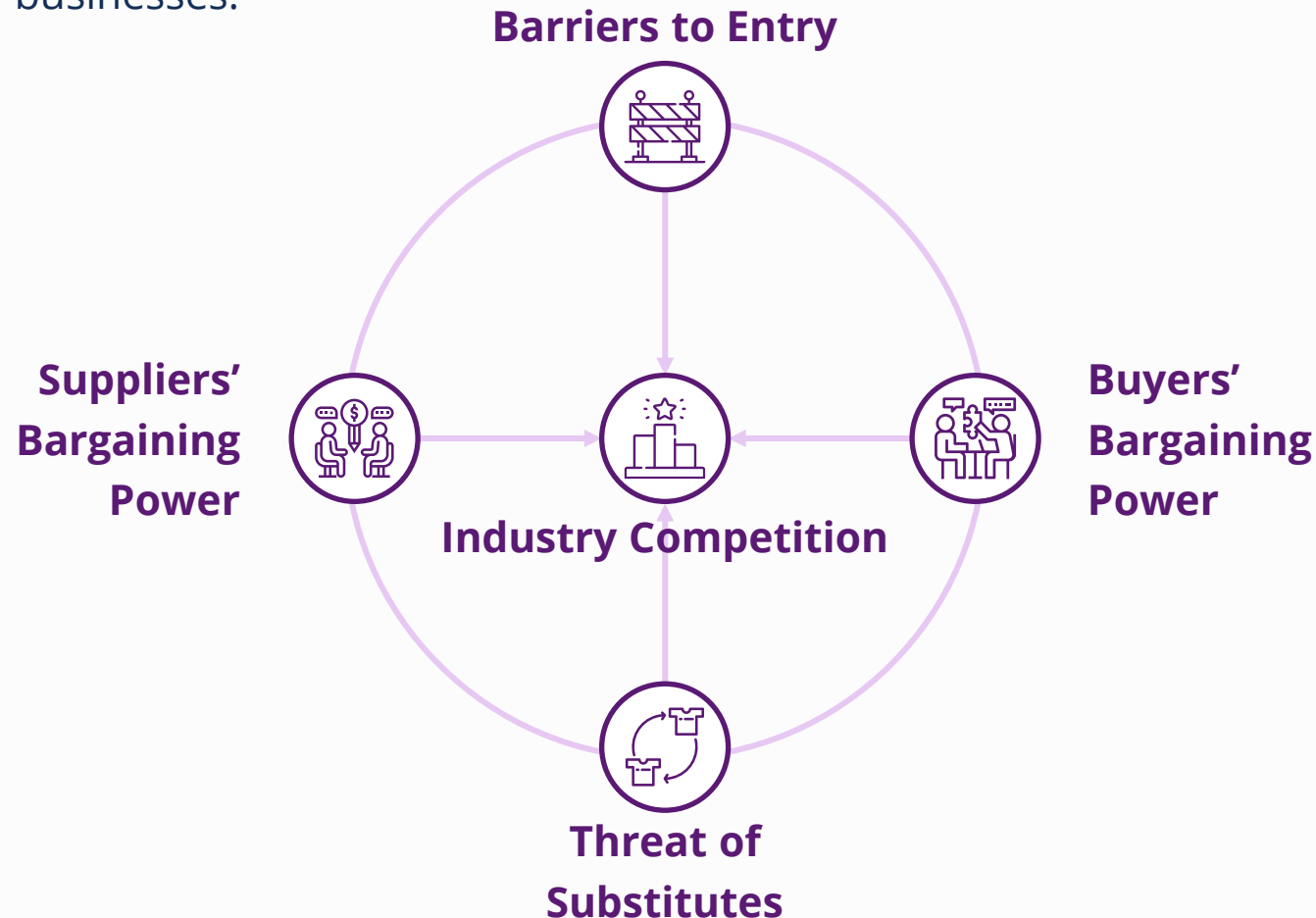
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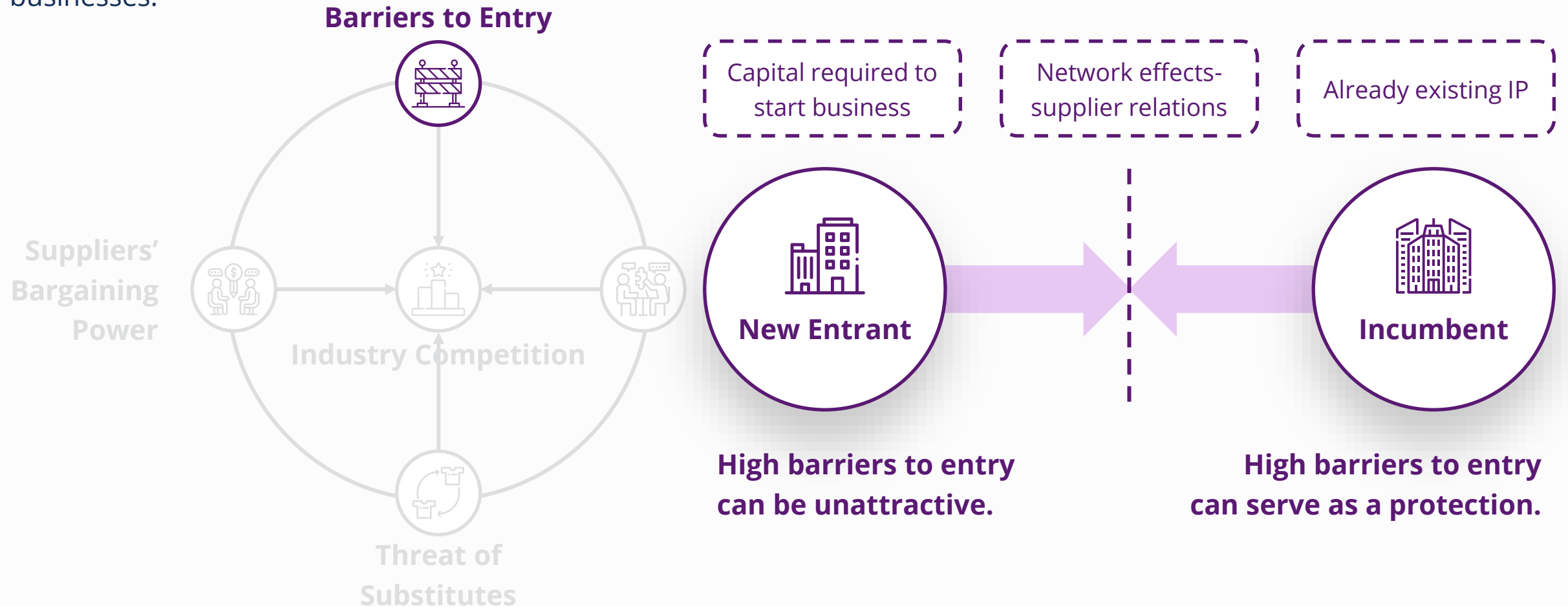
Porter's Five Forces

Porter's Five Forces is a framework used to understand the competitive forces that shape an industry. It was first published in 1980 by Michael Porter as a way for management teams to better understand risks & opportunities facing businesses.



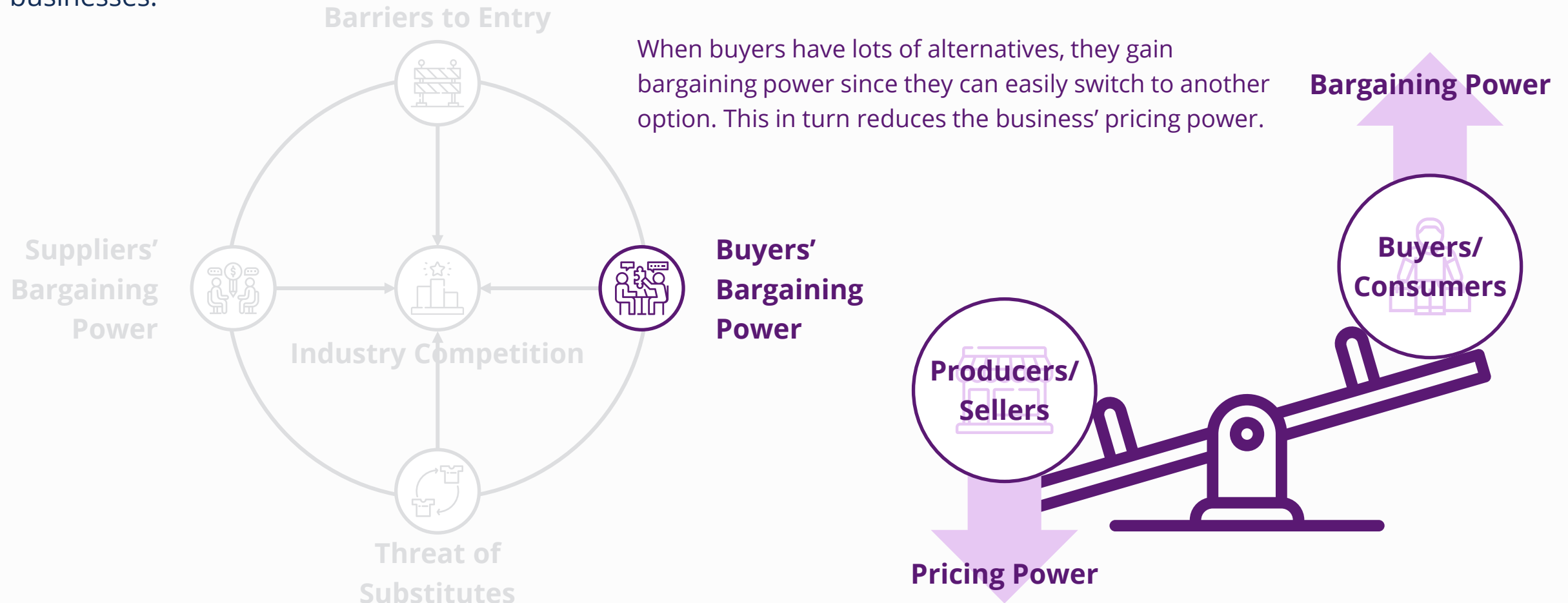
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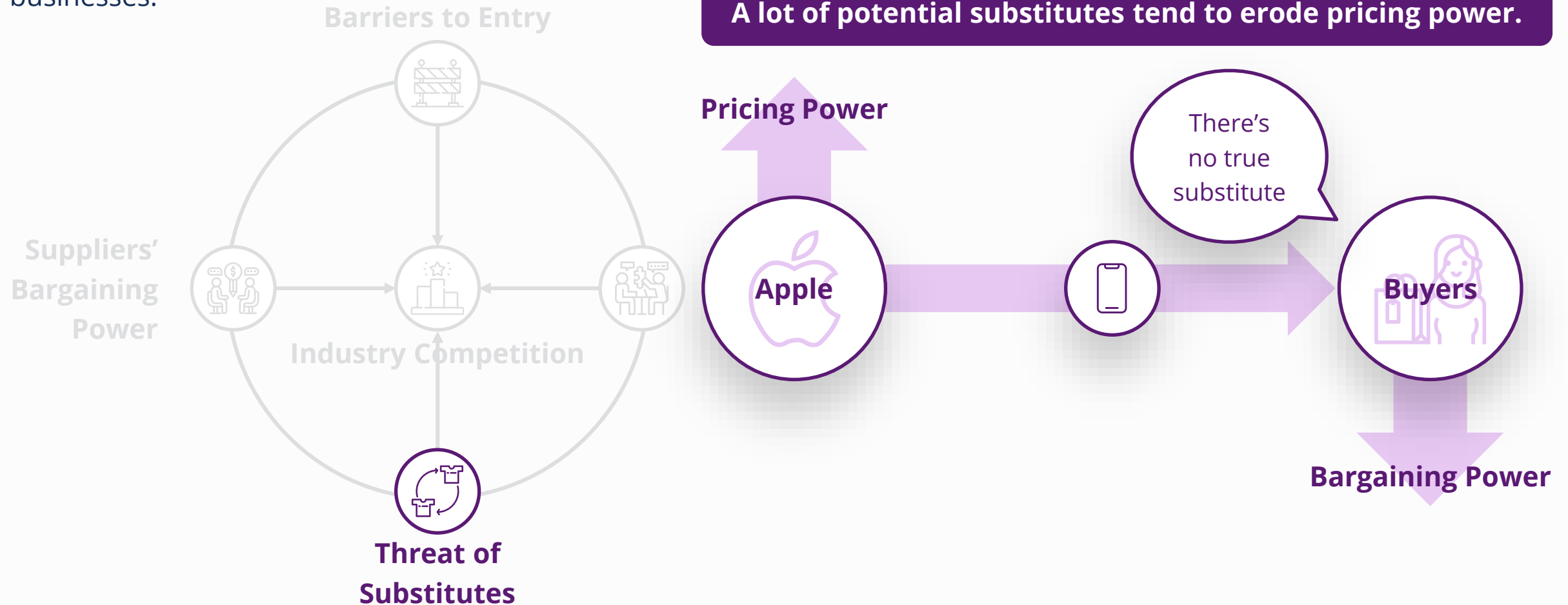
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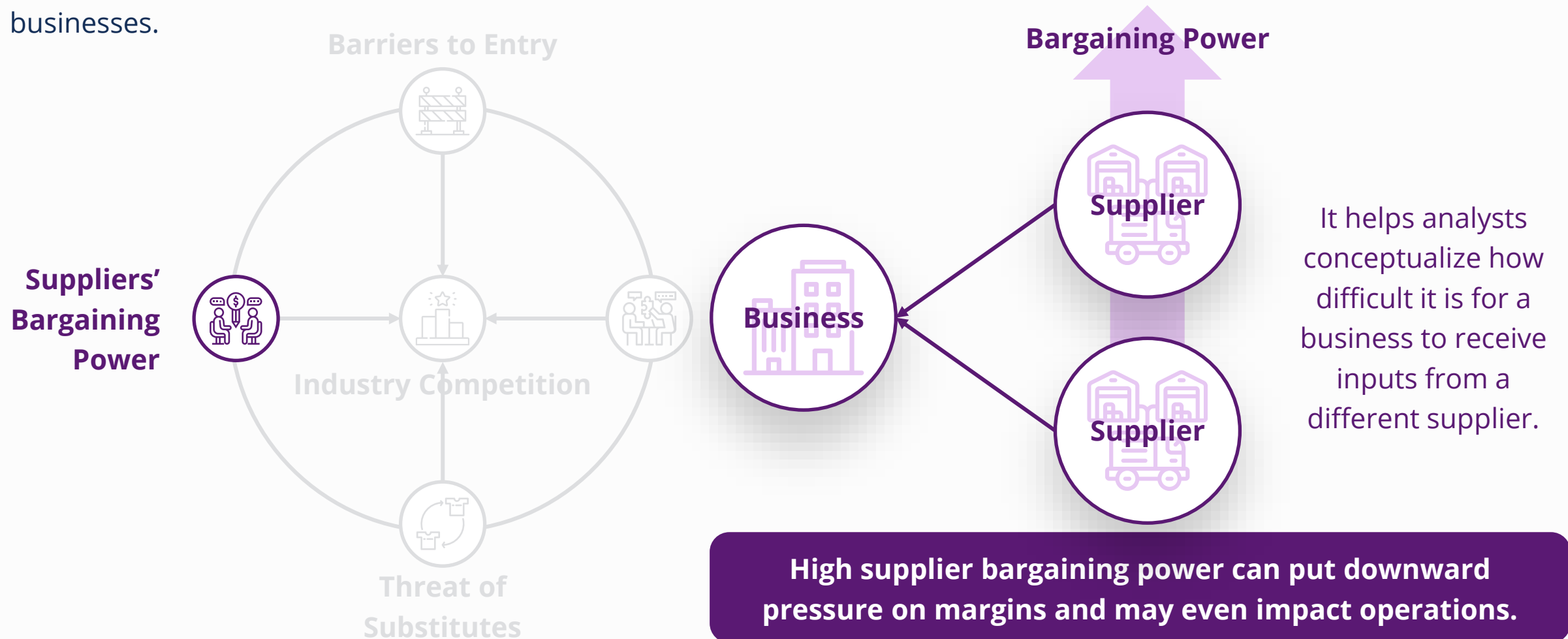
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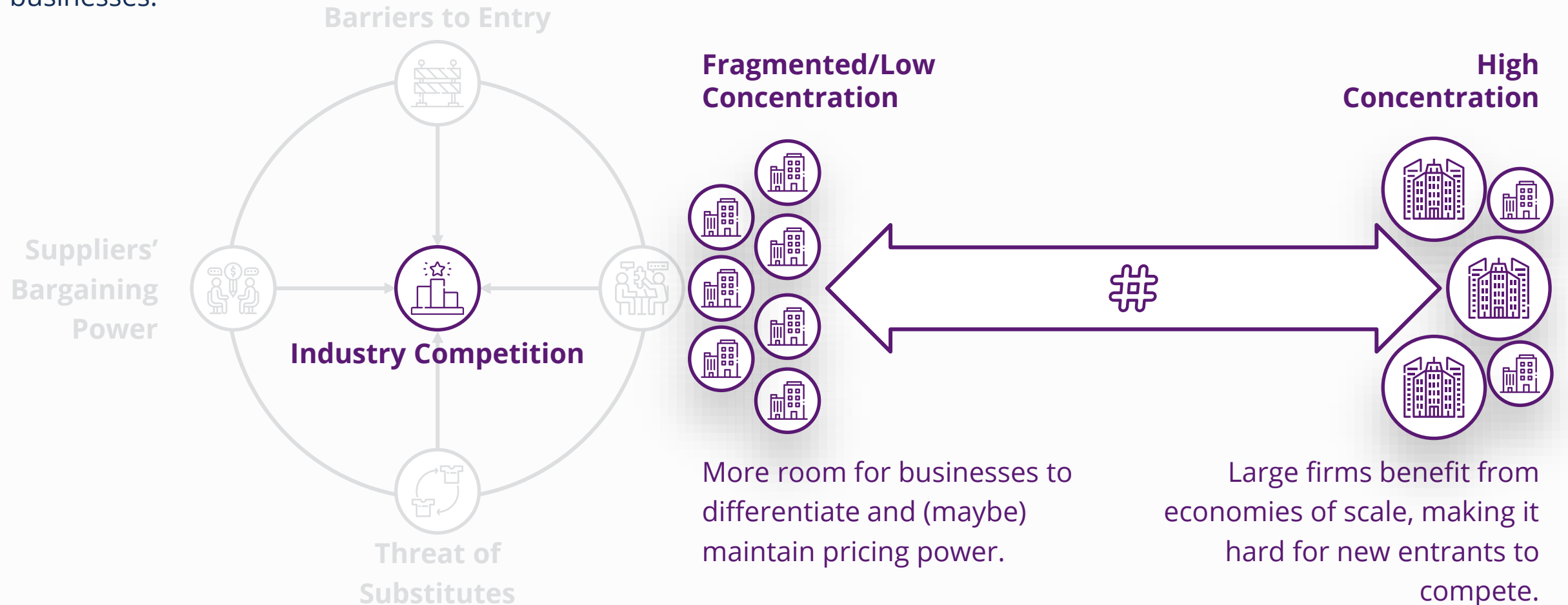
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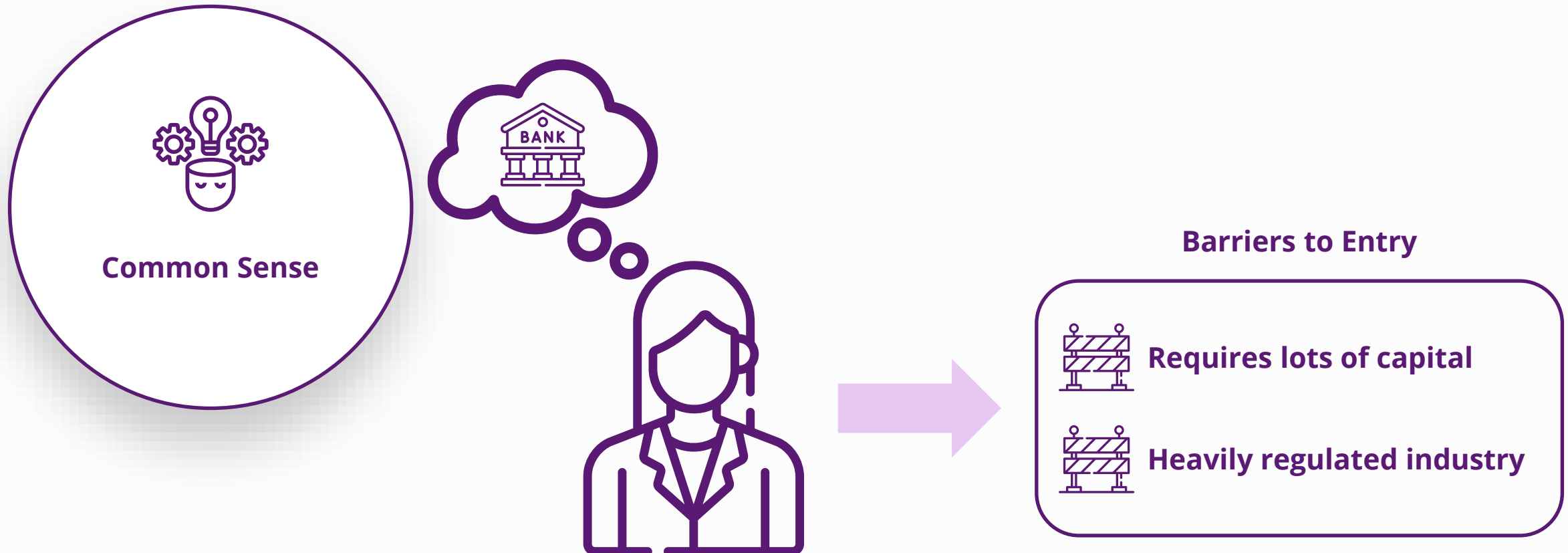
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Industry Research

A management team/analyst needs information to complete Porter's Five Forces or another framework. Some sources include:



Industry Research

A management team/analyst needs information to complete Porter's Five Forces or another framework. Some sources include:



Common Sense



**Primary Market
Research**



**Industry Research &
Data Providers**

Porter's Five Forces Example

Continuing with the small regional chain grocery store example:



Barriers to Entry

Moderate-to-high:

- Significant capital required to start up
- Moderate-to-high regulation in the food industry
- Big regional chains in the industry create barriers for new entrants with their economies of scale



Buyer's Bargaining Power

High bargaining power:

- Lots of substitutes for products, stores, and locations
- Many choices for consumers- high-end specialty offerings, low-cost discount stores, and all in between



Threat of Substitutes

Low-to-moderate:

- Increasing level of substitutes (e.g., meal kits, availability of take-out)
- Increased prevalence of grocery delivery services (can be positive or negative depending on where the 3rd party shops)
- Low number of true substitutes



Suppliers' Bargaining Power

High bargaining power:

- Unless the store is a global grocer with some leverage with suppliers, it has low bargaining power
- Consolidation on the supplier side outpaced the fragmented grocery industry- most stores lack bargaining power with suppliers



Industry Competition

High concentration:

- Low margins as a result of high competition
- Less sensitive to economic cycles- consumer staple businesses are more stable compared to discretionary businesses

Industry Lifecycle

Industry lifecycle is another conceptual framework that can help assess how a business may fit into the industry.

Industries in decline



Fax Machines



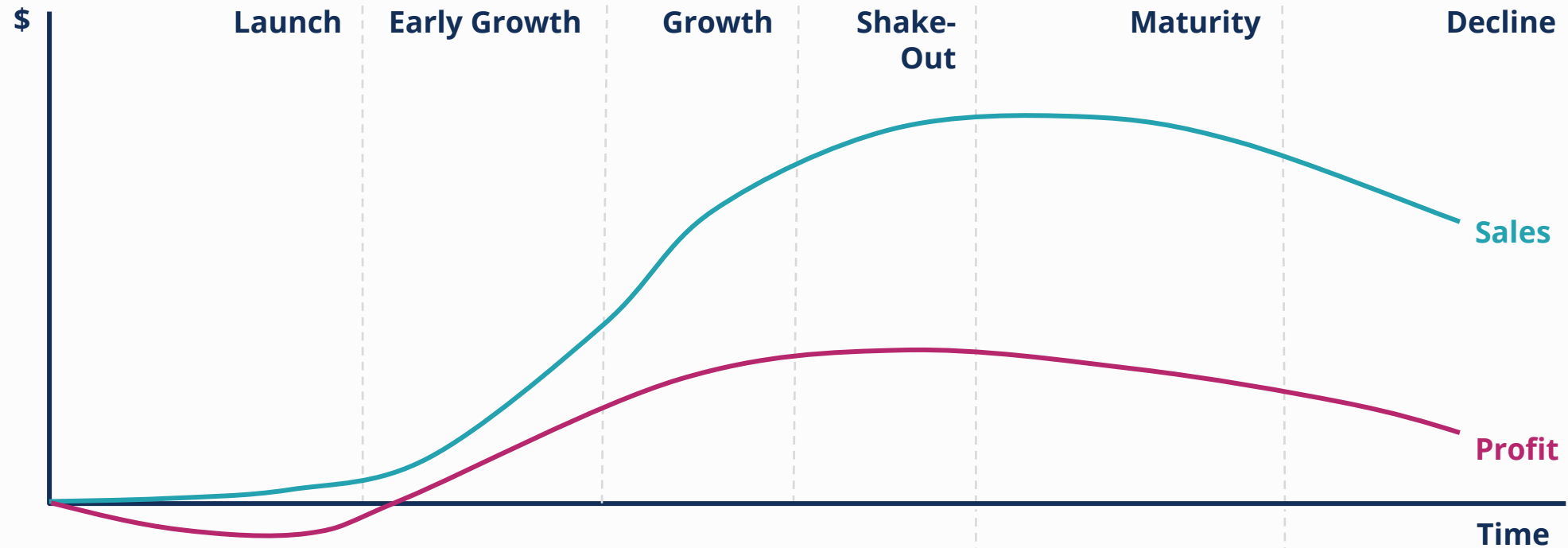
DVDs



Newspapers

Industries, like products and businesses, have life cycles.

Industry Lifecycle

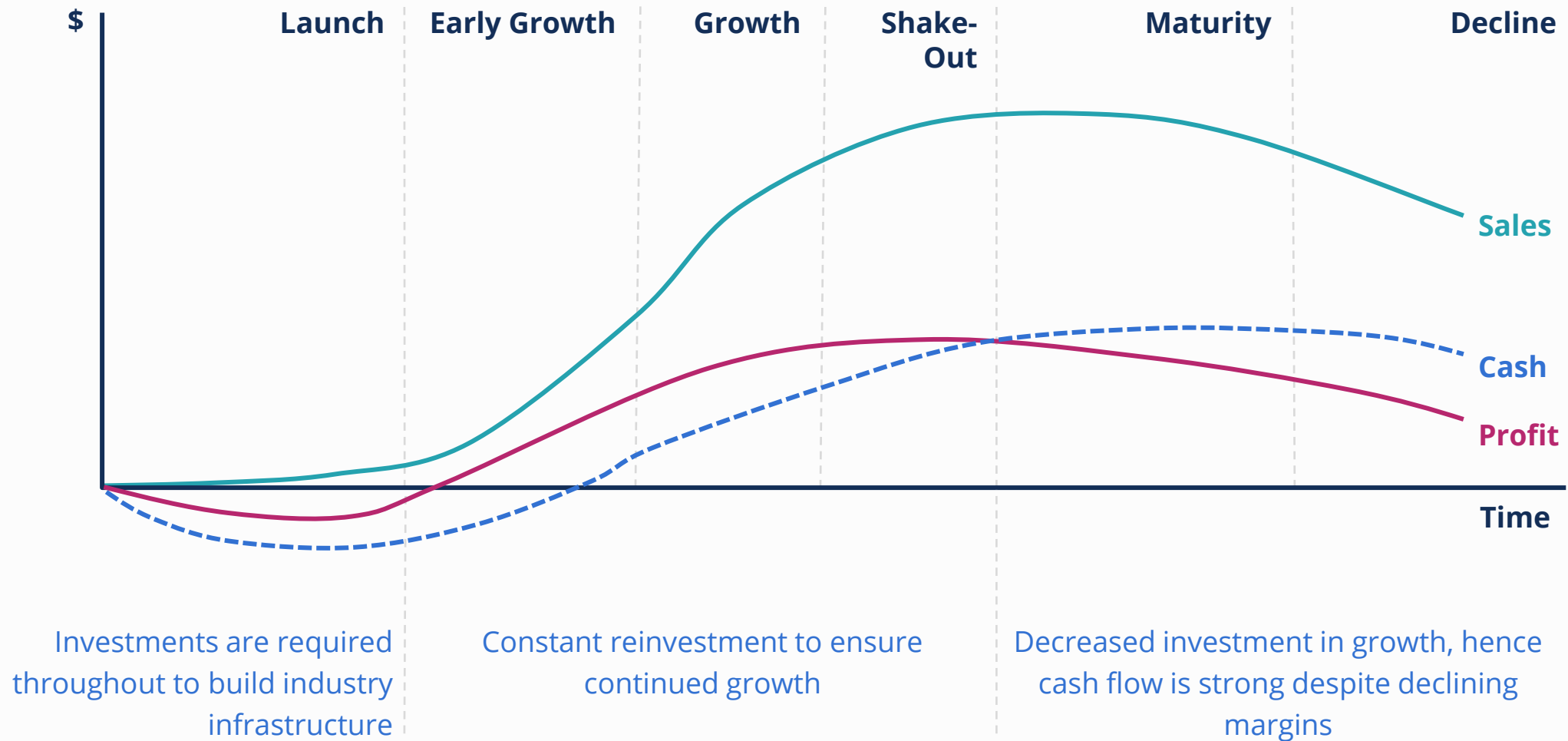


Established firms nearing their peaks while still benefiting from relatively attractive margins. Some firms try new products/services and fail or get consolidated (they'll "shake out").

Growth starts to decline
More consolidation
Less innovation

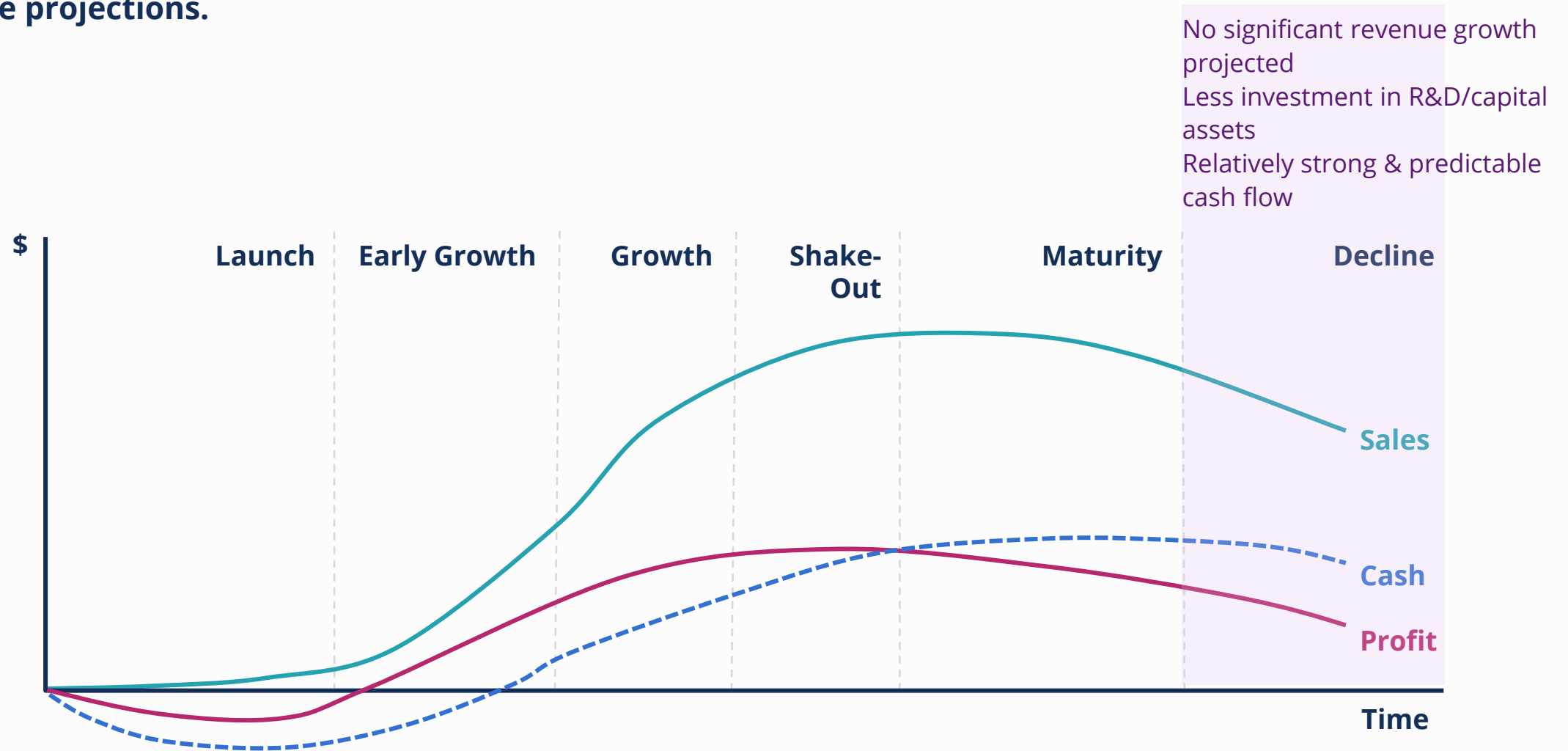
A lot of consolidation
Buying/merging with competitors may be necessary
Declining industry-wide revenue

Industry Lifecycle



Industry Lifecycle

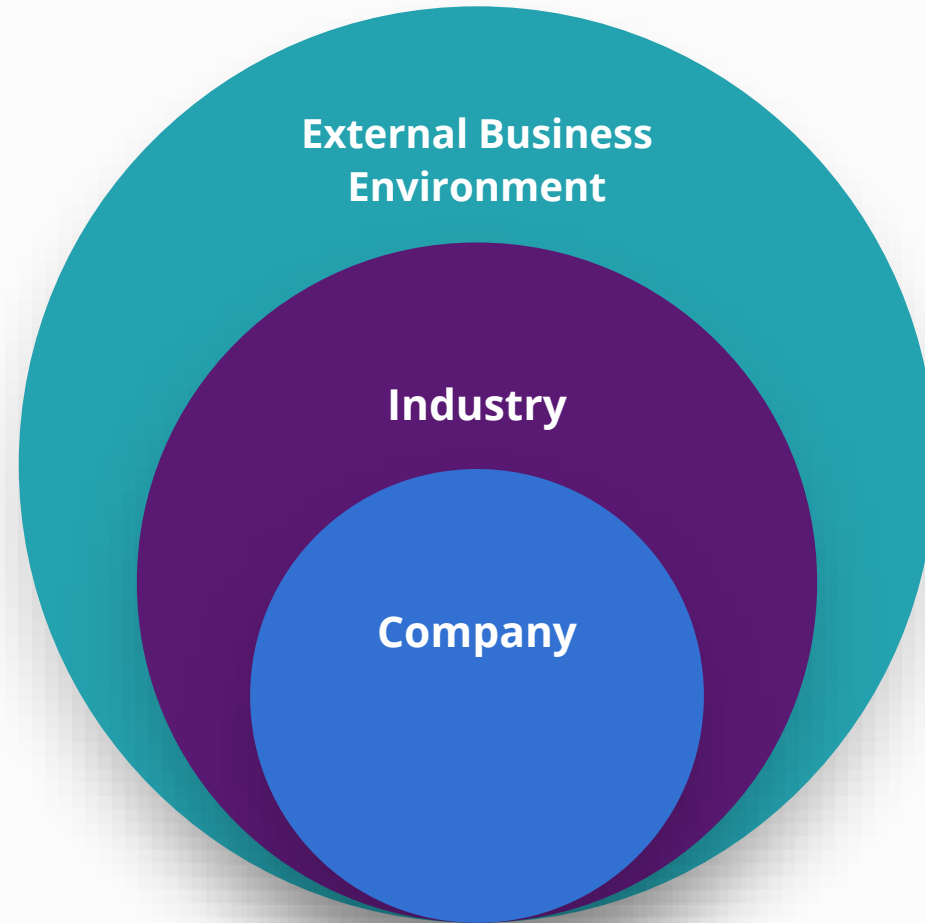
When analyzing a business, understanding where the industry is in its life cycle is very important as it will inform the projections.



Analyzing the Business

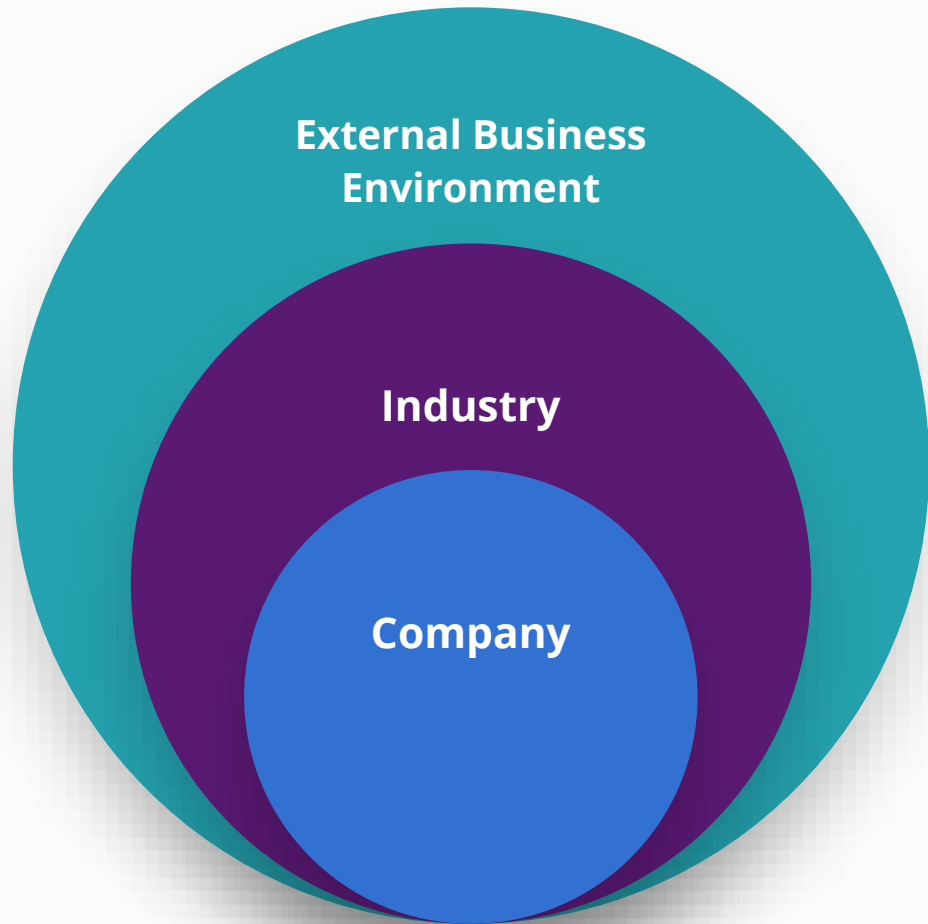
Analysis Framework

The role of financial analysts is to understand a company inside and out.



Analysis Framework

Frameworks to analyze businesses include:



Competitive Positioning

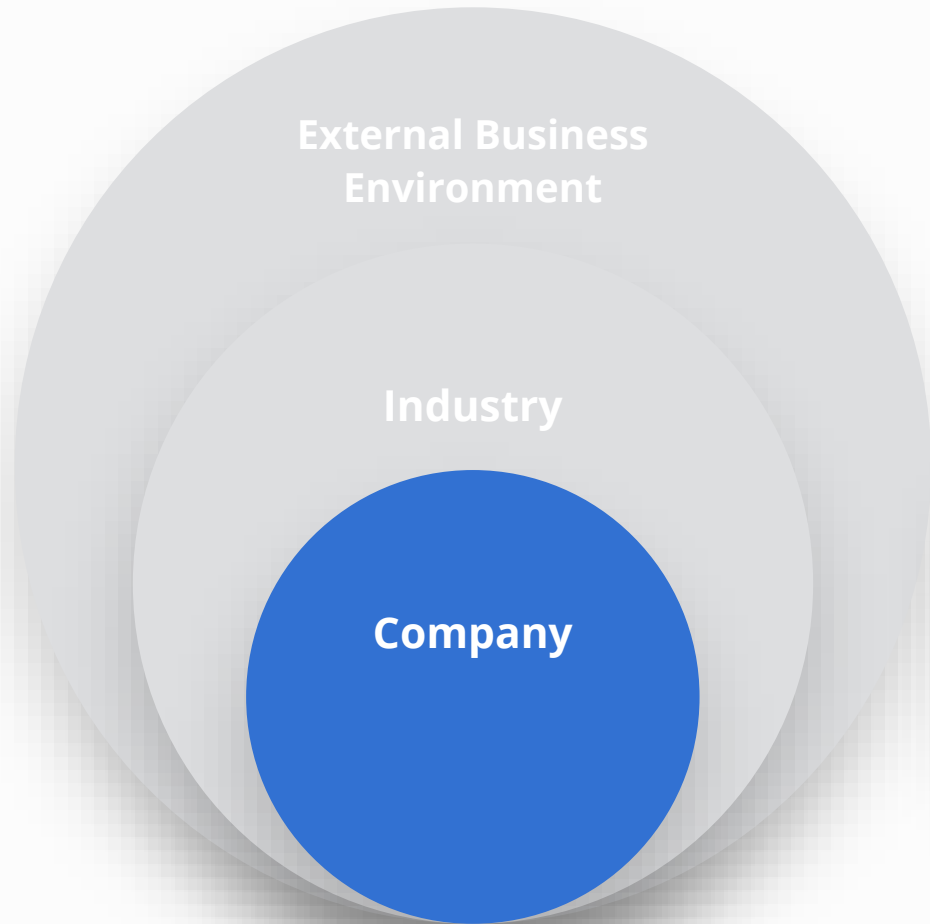


Competitive Advantage



Analysis Framework

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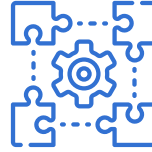


Understanding Competitive Position

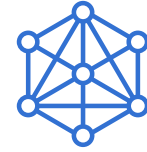
Companies can create relationships with their customers through different types of value propositions. These can be categorized into three main groups:



Best Product



Total Customer Solution



System Lock-in

Understanding Competitive Position

Companies can create relationships with their customers through different types of value propositions. These can be categorized into three main groups:



Best Product



Total Customer Solution



System Lock-in



**Lowest cost
product**



**Most
differentiated/
unique product**

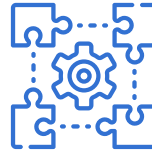
These companies are focused on products and use this to form a relationship with their customers.

Understanding Competitive Position

Companies can create relationships with their customers through different types of value propositions. These can be categorized into three main groups:



Best Product



Total Customer Solution



System Lock-in

The business and its management team are focused on the full experience of its customers.

**Complete set of
products/services**

**Provide lots of
solutions in one
place**

Understanding Competitive Position

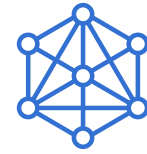
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Best Product



Total Customer Solution



System Lock-in

Exclusive channel to draw in customers. This can include 3rd parties that complement the value within the channel.

Understanding Competitive Position

Companies can create relationships with their customers through different types of value propositions. These can be categorized into three main groups:



Best Product

Lowest cost:

Walmart 

Differentiated/premium:

SONY

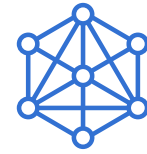


Total Customer Solution

Large financial institutions:

BANK OF AMERICA 

BoA offers a broad range of banking solutions, investment products via its affiliation w/ Merrill Lynch, wealth & estate planning, and private & retail banking solutions.



System Lock-in

amazon 

Amazon has an exclusive sales channel with many 3rd parties that sell and add value to the channel, creating an unprecedented network effect.

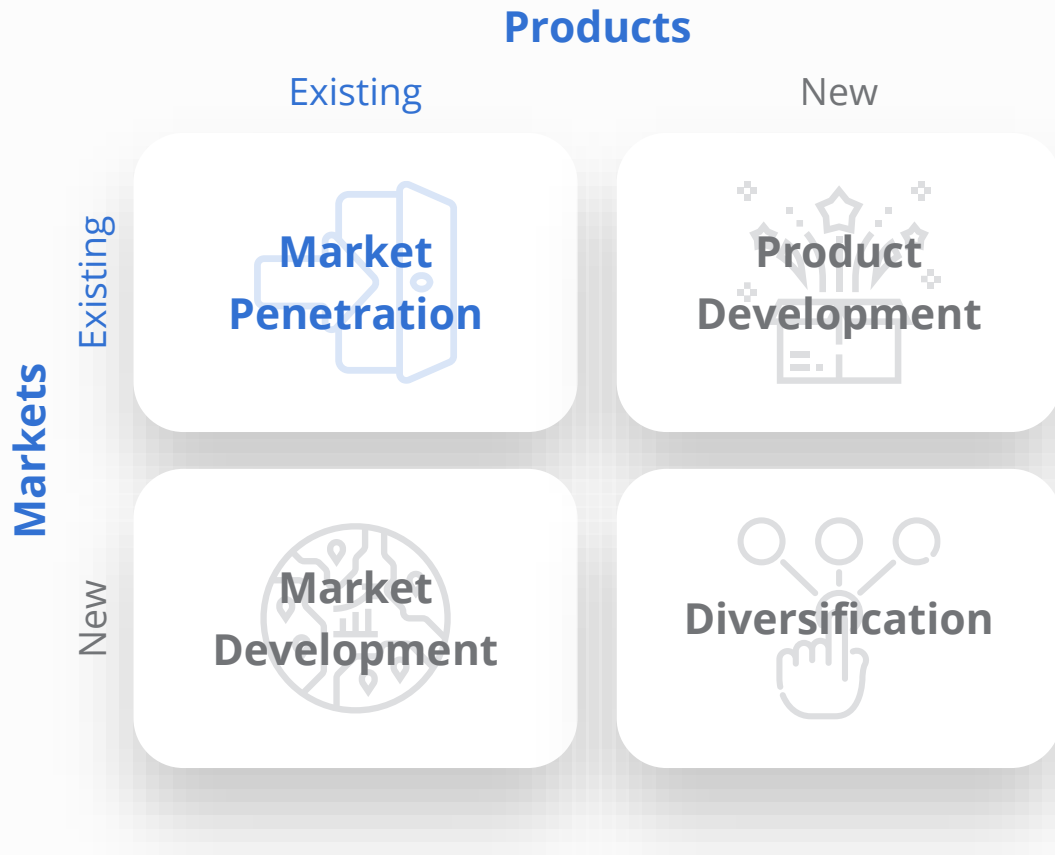
Ansoff Matrix

The Ansoff Matrix is a popular tool for assessing a company's strategy. Sometimes referred to as the product/market expansion grid, **it helps stakeholders visualize the relative attractiveness and risk between growth strategies.**



Ansoff Matrix

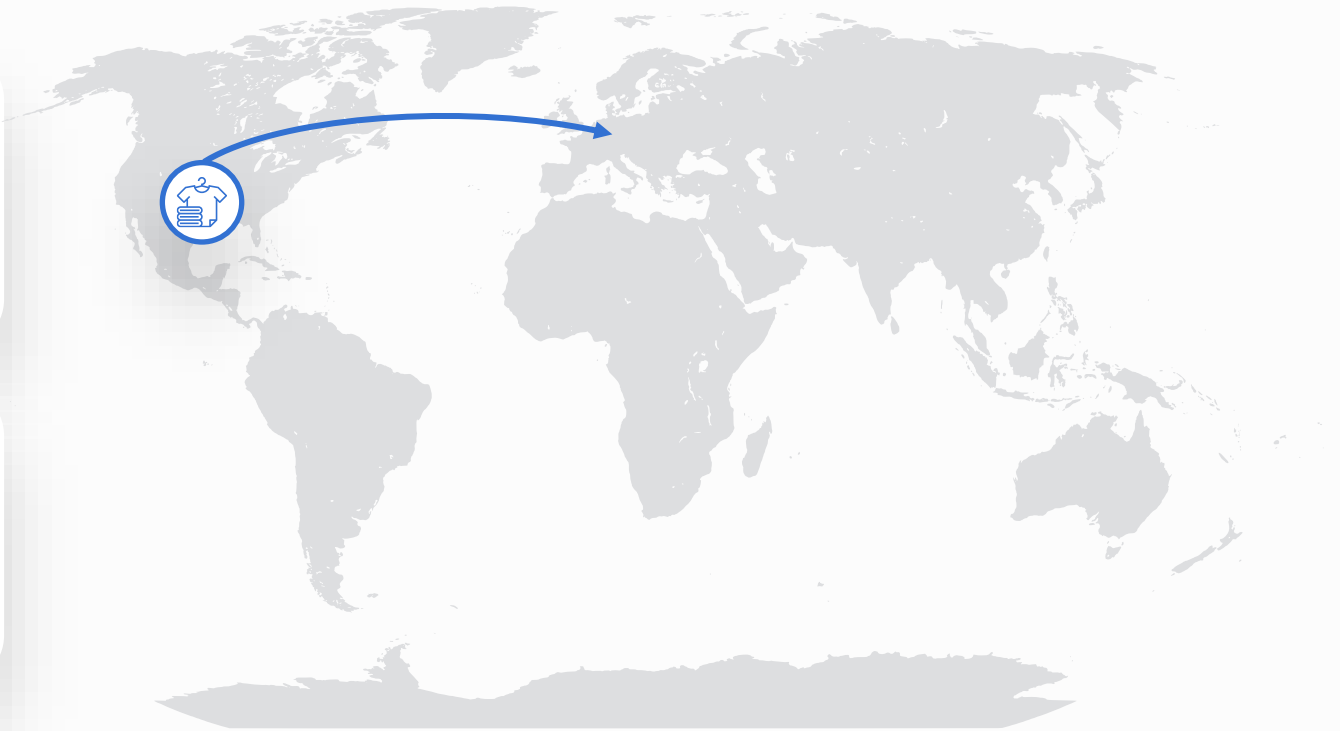
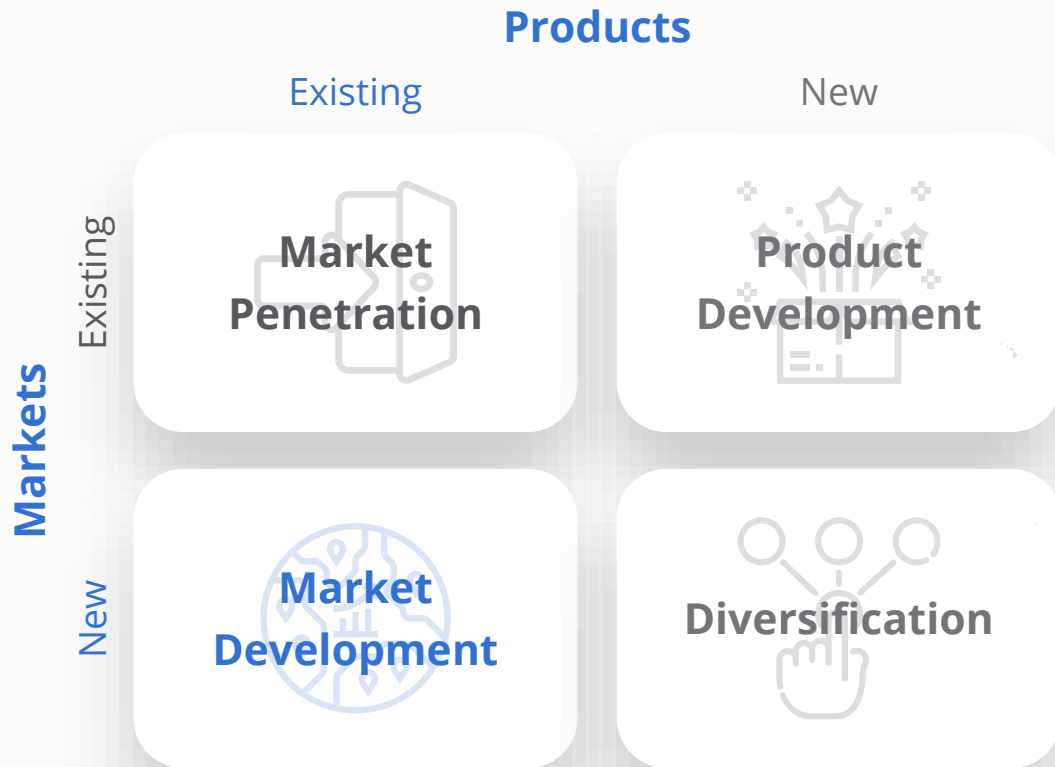
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Telecommunications firms are notorious for undercutting one another to gain market share, using introductory rates & other promotions.

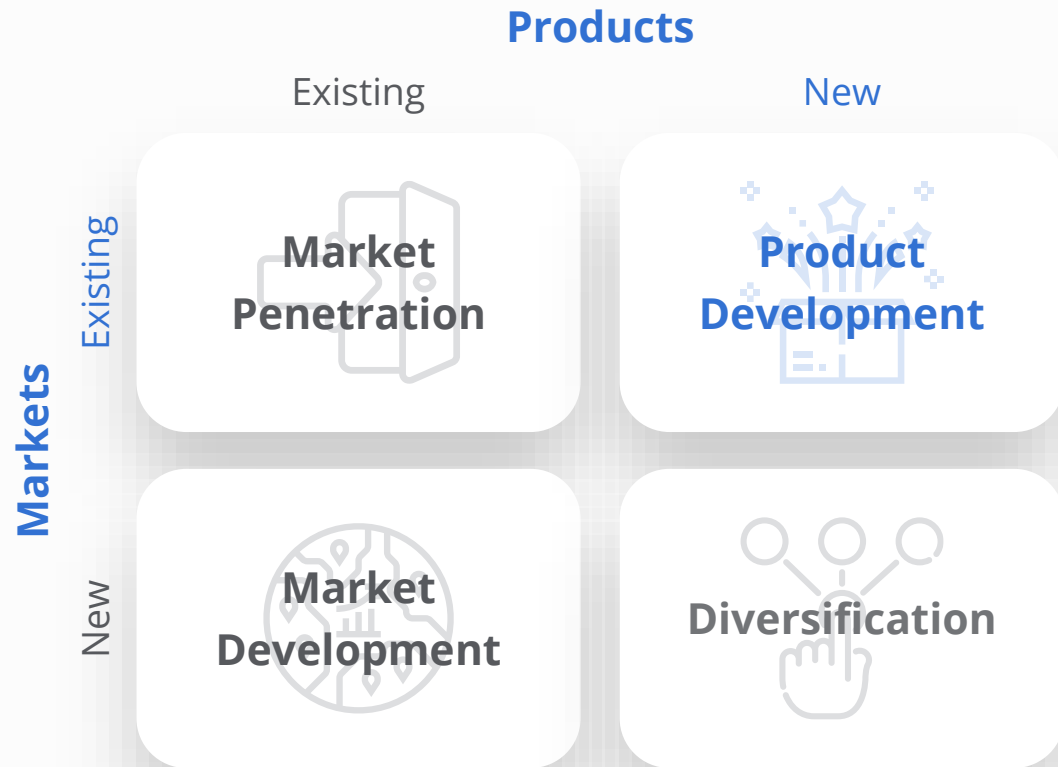
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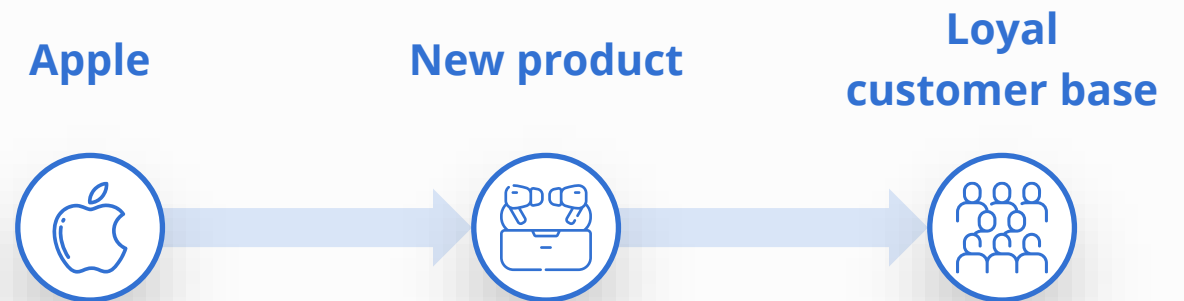


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Successful product development initiatives can sometimes play on brand loyalty.



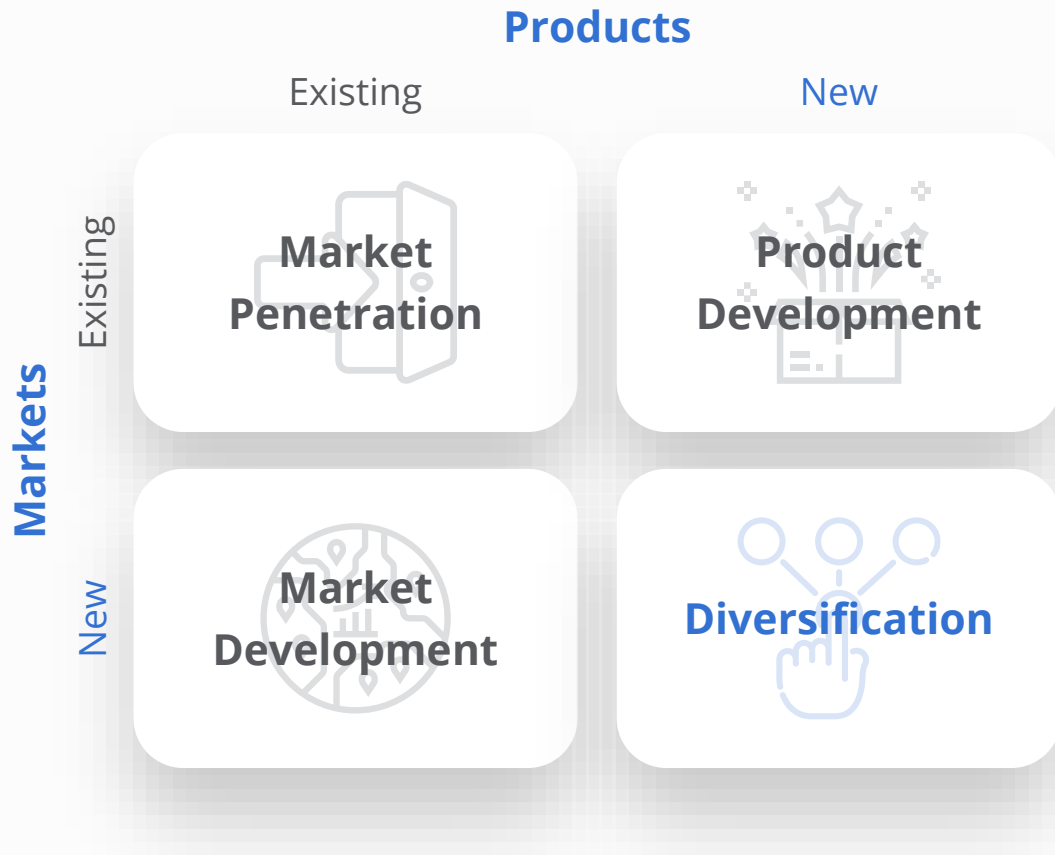
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There usually isn't a "one-size-fits-all" solution, and even the best strategies can fail due to poor execution.

SWOT Analysis

While SWOT itself is an assessment framework, it also acts as a summary exercise where we **examine findings from the other frameworks to highlight intrinsic, as well as extrinsic features of the business.**

Intrinsic

Extrinsic

S



Strengths

W



Weaknesses

O



Opportunities

T



Threats

SWOT Analysis

S



Strengths

Characteristics that give the business a competitive advantage over others.

- Good reputation
- Massive brand awareness
- Best-in-class margins
- Pricing Power
- Experienced mgmt. team

W



Weaknesses

Characteristics that give the business a disadvantage relative to its competitors.

- Inexperienced mgmt. team
- Cyclical sensitivity
- High costs
- Weaker-than-benchmark financial metrics

O



Opportunities

Elements in the external environment that allow it to formulate & implement growth strategies.

- Potential acquisitions
- Growing total addressable market (TAM)
- Potential product/market expansion

T



Threats

Elements in the external environment that can endanger the business and its ability to operate.

- Significant economic/industry-wide disruption
- Changes in social trends
- Environmental risks

Connecting the Frameworks to Financial Analysis

Translating Growth Drivers & Business Risks into Financial Analysis

Financial analysis is always conducted with an end goal in mind. **Ask yourself, what's the question you want answered?**

1

**Assess growth drivers &
business risks**

2

**Translate findings into
model assumptions**

This will help you capture unique economic, industry, or company-level characteristics that may influence the success or failure of a business.

ABC Sporting Goods

S



Strengths




- Management acumen/ experience
- Well-known brand w/ strong reputation
- Steady sales growth in line with industry norms

W




Weaknesses

Historically...

-  Supplied around 12 notable, regional chains & 7-8 school districts
-  No significant customer concentration risk, as mgmt. had good relationships
-  Payment terms in line with industry norms

Last Year...

-  Last year, Walmart's procurement team approached mgmt. and signed a contract to stock some of ABC's products

ABC Sporting Goods

S



Strengths

- Management acumen/ experience
- Well-known brand w/ strong reputation
- Steady sales growth in line with industry norms

W



Weaknesses

- Concentration risk w/ Walmart representing >35% of sales & A/R
- High customer bargaining power (lower than avg. price on contract)
- Long payment terms (up to 90 days)

Political Climate

Raise corporate income taxes



Cut corporate income taxes



ABC Sporting Goods

S



Strengths

- Management acumen/ experience
- Well-known brand w/ strong reputation
- Steady sales growth in line with industry norms

W



Weaknesses

- Concentration risk w/ Walmart representing >35% of sales & A/R
- High customer bargaining power (lower than avg. price on contract)
- Long payment terms (up to 90 days)

O



Opportunities

- Potential to expand the Walmart opportunity and grow revenue even further

T



Threats

- Considerable uncertainty around future corporate tax rates

MDM Medical

An analyst's due diligence includes gathering data, conducting management interviews, and other primary research.



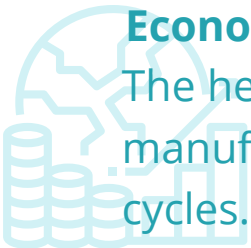
Political Factors

Healthcare reform is a “constant overhang” in the US. (-)



Technological Factors

The growing popularity of “minimally invasive procedures”. **(could be + or -)**



Economic Factors

The healthcare sector and medical device manufacturers have low sensitivity to economic cycles. (+)



Environmental Factors

The growing scrutiny around unsustainable materials that go into medical products. **(could be + or -)**



Social Factors

The aging population is creating industry tailwinds and considerable demand for medical devices. (+)



Legal Factors

Potential liability from faulty products; massive recalls can lead to a cash drain in the form of court-ordered settlements. (-)

MDM Medical

MDM Medical is a device and supplies manufacturer founded 18 years ago. They produce a variety of surgical instruments like forceps, clamps, and suture kits.



Best Product

IP7 Scalpel

Represents 40% of total sales



The company started with a network of distributors but set up its own sales force 5 years ago after building a strong brand & following.



Great relationships with hospitals & surgical centers; no significant customer concentration risk.



Historically they have tried to avoid “single-use”, disposable products as these were considered low-margin

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Best Product

IP7 Scalpel

Represents 40% of total sales



Total Customer Solution

Disposable/Single-use Products

Drive incremental revenue

Leveraging strong relationships with
existing customers to boost sales
without sacrificing margin

MDM Medical

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