



## Drivers of Industry Financial Structure

Common-sized financial statements and selected ratios of 10 companies, along with an explanation of key items, are presented in the following pages. The companies were chosen because they consist of primarily one major business segment and the relationships between balance sheet items, profit, and operations are fairly typical of these industries.

To facilitate accounting comparisons, the companies are all headquartered in the United States. The financial statements are the latest annual financials for the respective fiscal years ending in 1999 or 2000.

The companies involved are:

- Developer of prepackaged software
- On-line retailer
- Warehouse club for food and general merchandise
- Major passenger airline
- International hotel chain
- Temporary staffing agency
- Supermarket grocery retailer
- Pharmaceutical company
- Manufacturer of electronic communications equipment
- Manufacturer and marketer of consumer products

Use the ratios, common-sized statements, and your knowledge of business operations and conditions at the time these data were generated to identify the companies.

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*Research Associate Indra A. Reinbergs prepared this case under the supervision of Professor Dwight B. Crane as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The format of this case is based on HBS No. 198-017, "Identify the Industries—1996" and its predecessors.*

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EXPLANATION OF SELECTED ITEMS	
<b>Balance Sheet Items</b>	
Cash & Marketable Securities	Includes bank deposits and short-term, relatively risk-free, liquid investments such as U.S. Treasury bills.
Investments	Represents long-term equity investments in other companies.
Goodwill & Intangibles	Goodwill arises when one company acquires another for a price that exceeds the book value of the assets. The difference is put on the books of the acquiring company as goodwill or an intangible, such as brand value.
Current Portion of Long-Term Debt	The portion of long-term debt principal that must be paid within one year.
Total Long-Term Debt	Debt obligations with maturities beyond one year (e.g., bonds, notes, mortgages).
Preferred Stock	Carries a right to a fixed annual dividend payment (like interest on debt), but does not grant any voting rights. In liquidation it ranks behind debt obligations and ahead of common stock.
<b>Financial Ratios</b>	
Gross Margin	Measures gross profits on goods sold. <i>Calculated as (Sales-Cost of Goods Sold)/Sales.</i>
Research & Development/Sales	A measure of how heavily a company is engaged in developing new products and services.
Net Income/Sales	Net profit margin measures "bottom-line" profitability after consideration of all expenses and revenues.
Days of Receivables	Measures how long customers take to pay invoices. <i>Calculated as Accounts Receivable/(Net Sales/365).</i>
Inventory Turnover	Measures the firm's efficiency in managing and selling inventory. <i>Calculated as Cost of Goods Sold/Inventories.</i>
Fixed Asset Turnover	Indicates the capital intensity of the business. <i>Calculated as Sales/Net Property, Plant and Equipment.</i>
Total Asset Turnover	Indicates the asset intensity of the business. <i>Calculated as Sales/Total Assets.</i>
Net Income/Assets	"Return on Assets" (ROA) measures the firm's overall efficiency in managing assets.
Net Income/Equity	"Return on Equity" (ROE) measures the rate of return on the shareholders common stock investment.
Assets/Equity	A measure of how much the firm has leveraged or geared its shareholders' equity to provide higher returns to shareholders (owners). <i>Calculated as Total Assets/Common Stock.</i>
Debt/Equity	<i>Calculated as (Short-Term Debt + Current Portion of L/T Debt + L/T Debt)/Common Stock.</i> Another frequently used measure of leverage.
Long-Term Debt/Total Capital	<i>Calculated as L/T Debt/(Preferred Stock + Common Stock + L/T Debt).</i> Measures the extent to which long-term debt is used as part of the capital structure or long-term financing of the firm.

Note: See "Introduction to Financial Ratios and Financial Statement Analysis" for further reference, HBS No. 193-029.

## Exhibit 1 Common-Sized Financial Statements

	A	B	C	D	E	F	G	H	I	J	Median
<b>ASSETS</b>											
Cash & Marketable Securities	28.6%	1.6%	1.1%	6.9%	8.7%	9.0%	10.8%	5.6%	5.8%	62.0%	7.8%
Receivables	-	3.5%	4.3%	3.6%	9.2%	11.5%	13.7%	4.8%	58.3%	9.8%	7.0%
Inventories	8.9%	21.9%	1.0%	-	10.4%	8.0%	9.2%	41.6%	-	-	8.5%
Other Current Assets	3.5%	3.8%	1.9%	5.6%	7.1%	3.1%	10.5%	2.0%	7.1%	5.7%	4.7%
Total Current Assets	41.0%	30.8%	8.2%	16.2%	35.4%	31.6%	44.2%	54.1%	71.2%	77.5%	38.2%
Net Plant & Equipment	12.9%	46.1%	44.4%	69.3%	39.3%	27.2%	24.8%	44.8%	18.1%	8.6%	33.2%
Investments	15.0%	-	14.1%	5.0%	-	13.4%	-	-	-	-	-
Goodwill & Intangibles	29.5%	20.9%	25.1%	5.4%	21.2%	21.3%	-	-	6.6%	-	13.8%
Other Noncurrent Assets	1.6%	2.2%	8.2%	4.2%	4.1%	6.6%	31.0%	1.1%	4.1%	13.9%	4.1%
Total Noncurrent Assets	59.0%	69.2%	91.8%	83.8%	64.6%	68.4%	55.8%	45.9%	28.8%	22.5%	61.8%
<b>Total Assets</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	
<b>LIABILITIES AND EQUITY</b>											
Accounts Payable	18.7%	16.0%	6.6%	13.0%	7.2%	11.7%	8.1%	26.9%	7.1%	4.4%	9.9%
Short-term Debt	-	-	-	-	9.8%	8.0%	6.7%	-	4.6%	-	-
Current Portion of L/T Debt	0.6%	3.0%	0.1%	4.2%	-	-	-	0.0%	-	-	0.0%
Unearned Revenues	2.2%	-	-	11.0%	-	-	-	-	-	2.0%	-
Other Current Liabilities	8.4%	12.9%	0.1%	4.0%	16.5%	4.9%	18.5%	14.8%	32.0%	26.9%	13.9%
Total Current Liabilities	29.9%	31.9%	6.8%	32.2%	33.5%	24.6%	33.3%	41.7%	43.7%	33.3%	32.7%
Total Long-Term Debt	59.3%	44.8%	65.8%	11.8%	19.4%	8.8%	8.3%	0.2%	-	-	10.3%
Other Noncurrent Liabilities	-	8.4%	12.1%	27.9%	9.5%	29.4%	13.4%	4.4%	-	3.0%	9.0%
<i>Total Liabilities</i>	<i>89.2%</i>	<i>85.1%</i>	<i>84.7%</i>	<i>71.9%</i>	<i>62.5%</i>	<i>62.8%</i>	<i>54.9%</i>	<i>46.2%</i>	<i>43.7%</i>	<i>36.3%</i>	<i>62.6%</i>
Preferred Stock	-	-	-	1.2%	5.5%	-	1.3%	-	-	-	-
Common Stock	10.8%	14.9%	15.3%	26.9%	32.0%	37.2%	43.8%	53.8%	56.3%	63.7%	34.6%
<i>Total Stockholders' Equity</i>	<i>10.8%</i>	<i>14.9%</i>	<i>15.3%</i>	<i>28.1%</i>	<i>37.5%</i>	<i>37.2%</i>	<i>45.1%</i>	<i>53.8%</i>	<i>56.3%</i>	<i>63.7%</i>	<i>37.4%</i>
<b>Total Liabilities &amp; Equity</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	
<b>SELECTED RATIOS</b>											
Gross Margin	17.7%	26.5%	43.2%	38.3%	44.4%	46.4%	38.0%	11.4%	17.9%	90.7%	38.2%
R&D/Sales	9.7%	-	-	-	-	6.5%	11.1%	-	-	19.8%	-
Net Income/Sales	(43.9%)	1.4%	8.1%	7.4%	9.9%	18.1%	2.6%	2.6%	2.0%	23.4%	5.0%
Days of Receivables	-	5	N/M	15	28	46	60	5	52	28	28
Inventory Turnover	6.1	8.5	N/M	-	6.4	6.2	5.6	8.3	-	-	6.1
Fixed Asset Turnover	5.163	5.481	0.523	1.283	3.020	3.381	3.345	8.740	22.829	14.687	4.272
Total Asset Turnover	0.663	2.524	0.232	0.889	1.187	0.918	0.829	3.918	4.130	1.263	1.053
Net Income/Assets	(0.291)	0.035	0.019	0.066	0.117	0.166	0.022	0.104	0.082	0.296	0.074
Net Income/Equity	(2.704)	0.234	0.123	0.245	0.366	0.447	0.050	0.192	0.146	0.464	0.213
Assets/Equity	9.282	6.696	6.539	3.719	3.125	2.691	2.284	1.859	1.775	1.569	2.908
Debt/Equity	5.561	3.198	4.307	0.596	0.913	0.453	0.342	0.004	0.081	-	0.525
L/T Debt/Total Capital	0.846	0.750	0.811	0.296	0.341	0.192	0.155	0.004	-	-	0.244

Note: “ - ” = Category not reported separately on financial statements. “N/M” = Category not meaningful.