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If you are looking for the best market, industry or sector to invest in; the "best-in-class" companies to invest in or work with; and need good, current and objective insights to do so, then this is the book for you.

Picking Winners is the culmination of the author's knowledge and insights from more than two decades of market experience and research on what makes a business "best-in-class". It will provide you with the tools to make objective assessments and decisions. Leveraging on the analytical frameworks that build on company-level financial data, companies and individuals now have a new point-of-view to assess markets, sectors and industries. You can benchmark and create personal value-chain models for strategy and planning, and make decisions based on quantitative data that show:

- The median profitability of 24 major markets, 10 major sectors and 50 industries
- The way markets, sectors and industries are organized
- The degree of entry barriers into a market, sector or industry
- The performance of companies in a market, sector or industry

Complemented with a website that provides up-to-date information on the markets, sectors, industries and up to 1,500 key global companies, the book will be a valuable resource for any business and individual.

FRANCIS TAY has been engaged in business, entrepreneurial activities and market intelligence in public and private enterprise for more than two decades. His range of experience cuts across tech-driven projects and companies such as those that deal with water treatment and high-tech fish farming, to distribution and retail. Tay also teaches Business Intelligence and Information Entrepreneurship at the post-graduate level and mentors entrepreneurs and businesses. His earlier book *Turning Good Ideas into Great Businesses* was also published with Marshall Cavendish.

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Francis Tay PICKING WINNERS Marshall Cavendish Business

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Making Data-driven Investment Decisions

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To the many individuals who have passed
through my classroom in nearly a decade,
whose interest in business insights and analytics
has been the source of my motivation.

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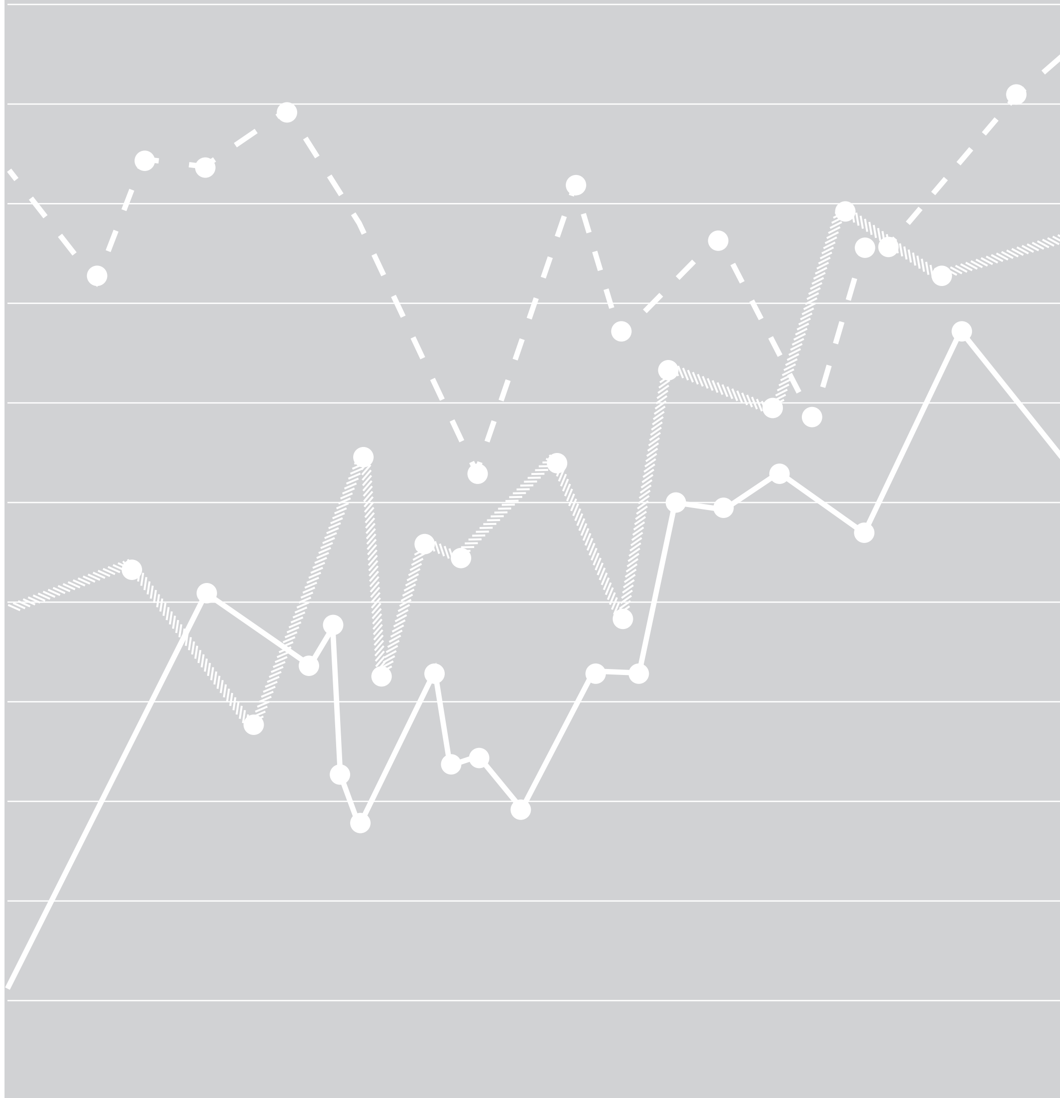
Introduction

Reality Check



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This book has been written with three objectives. The first is to provide business owners with the means and ways to identify markets and sectors to expand into, benchmarking themselves with other businesses. Secondly, it is to help entrepreneurs and start-ups to identify opportunities with the best profit potential. Last but not least, this book is to help individuals and companies spot current and future winners, i.e. companies that have the ability and capability to create value and do it on a sustainable basis.

The fundamental approach of the book is to use the most current performance data of companies (approximately 1,200 of them) as the base from which market and sector models will be built. The companies that form the database for my analyses are those that have been chosen by the major stock exchanges as representative of their industries. As these companies come from the 24 countries that represent about 80% of the world's GDP (Gross Domestic Product), we can expect that the performance of these companies will have an impact on the performance of companies all over the world.

The analyses in this book are not about how well or how poorly the 1,200+ companies have done in a year, but rather what we can infer from their performance, and how we can project the future performance of the industry, sector and market that they are in. The overall performance of an industry, sector or market will have a bearing on the decisions that companies make during the year and beyond. Many decisions made these days — good or bad, right or wrong — are more often than not, based on information that is broad-based, somewhat subjective and qualitative in nature.

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Most of us make decisions based on imperfect and incomplete information most of the time. The volume of information available to us, together with the speed and the variety of the information, only adds to the challenge. The speed at which decisions have to be made implies that at some point, we need to stop the avalanche of input and start doing something with it. However, more objective and quantitative information, regardless of the volume, will lead to better decisions.

The main focal point of this book is thus about putting more objectivity into your decision-making process. The purpose is to add value to the decisions made — which market to expand into; which industry to get into; what partnerships to forge; how to price one's products and services; and how to identify the risks and opportunities for your business, as well as companies to invest in and projects to pursue. At the end, it is about being and doing the best we can.

THE STARTING POINT

The starting point is relatively simple. If you want to be the best, you need to first know where you stand. I am a believer in the importance of knowing where one stands in the scheme of things.

In life, the combination of experiences and lifelong learning plays a big part in moulding how a person views both success and failure. Knowing where one stands has both advantages and disadvantages. On the plus side, it provides a sense of reality and practicality for the decisions one makes. On the negative side, it can lead to overthinking situations, contribute to cynicism and

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impede innovation and creativity. To each, there will be a fine balance that is guided, in my opinion, by one's goals, ambitions and definition of an acceptable lifestyle.

In business, it is very much the same. The difference between being a part of a family business and investing in entrepreneurial businesses, is sometimes indistinguishable. There is a reason why investors always say that it is better to invest in a Grade "A" entrepreneur with a Grade "B" idea than a Grade "B" entrepreneur with a Grade "A" idea. The success of a business — be it family-owned, entrepreneurial, or a professionally run conglomerate — is more often than not, the result of the ability of the business leaders, rather than the business model per se. In any business model, type or size, the firm needs to know where it stands in the scheme of things. The environment in which a firm operates will constantly be changing and only through scanning the market and benchmarking one's ability and capability, will the firm be able to attain its goals.

Too often, firms focus on chasing revenues and basking in the euphoria of immediate and short-term successes. Firms get caught up in the upside of opportunities and tend to ignore, by choice or otherwise, the downside. I have personally experienced this in one of my investments. On paper, the project was great. We had the right people with the right expertise to take the project forward and the pipeline was good. When the project got underway, signs of problems emerged that would impact the original upside assessment. However, the projected end result was still too good to be ignored and so we pressed on. What came next was a deal-breaker. The expert manager started a competing

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project which we only found out later and things headed south. We did not (perhaps it did cross our minds on hindsight) expect to lose the key man in the project. Due to the project's specialised nature, we could not find an adequate replacement soon enough to carry on with the business.

Every failure is a heartbreak. However, with every failure there comes new learning. In my case, the key learning was about the importance of taking stock of the situation as frequently as necessary, to assess where we stand and to not simply discount risks.

Although I have been involved in business, in one way or another, for more than two decades, I am still learning. And I find the pace of learning has accelerated over the past five years, in part through the observation of my teenage children and their peers, the millenial generation. The pace at which I acquired experiential knowledge is nowhere near that which the current and future generations will be facing. Globalization, the copious amounts of information created and consumed, and the social demographic changes, have created an unprecedented amount of knowledge, risks and opportunities. We are entering an era where we will probably have five generations of people in one company — the traditionalists, baby boomers, Generation X and the millennials (Gen Y and Gen Z).

As many economies move into the knowledge era, what has contributed to a firm's success can easily change overnight. Firms need to step up their sensing capabilities and benchmarking efforts to know where they stand and make short, medium and long-term decisions based on as many facts as possible.

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The challenge here is not what facts to acquire and analyse, but rather how to discern what is fact and what is fiction from all the information out there; and how to operate with as little cost and as little risk as possible.

Firms need to benchmark not only to find new areas of opportunities for growth but to also be alert to risks and market developments that could potentially derail their business. In a recent survey of more than 400 turnaround managers and restructuring experts regarding what factors, in their experience, led to corporate crises, the following were the top ten causes:

1. Management continuing with a strategy that was no longer working for the company, possibly signalling a resistance or inability to change.
2. Losing touch with the market and their customers and not wanting (or able) to adapt to changes occurring around them. The customer is the reason why firms exist and not listening to them is as good as not doing the business.
3. Management has lost its vision. In a dynamic and ever-changing environment, losing or having no vision is tantamount to giving up the competitive fight. Clinging on to status quo will almost certainly lead to decline. Few companies have the luxury of being able to keep their market share and profitability by just hanging on to the status quo.
4. Insufficient control in the accounting processes, in particular financial and liquidity planning. Over-focusing on sales rather than profits can lead to a firm

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spiralling out of control and out of business. Having a better process helps, though it must also come with a better understanding about what this process is and what is required.

5. Weak internal communication. There are a number of reasons why internal communication can be better; they include staff not knowing what or how to communicate, and turf guarding. In a knowledge-driven world, information is necessary for business success.
6. Underestimating changes in the market. Operating in a silo and basing analyses on just one or a narrow perspective is as good as setting up the business to fail. Feedback, group-think, and independent views are all important in assessing a market.
7. Management lacking business knowledge. Starting a business or getting into a new segment or industry for the following reasons is wrong: Because the opportunity presents itself, because others are seemingly successful in it, because there is nothing else that can be done with the current business. These will usually not provide a solution to a business crisis.
8. Too much bureaucracy. Bureaucracy is not simply a process issue, it can also be a personal and human issue. Like better communication, a better process (cutting red tape, streamlining reporting structures, etc.) helps. However, it is important to have a good understanding of how people work (especially with a varied and culturally diverse workforce) and what motivates them.

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9. Failed expansion into other product or service markets. Such failures often occur through a lack of knowledge of the new market or segment. Although such failures could also be due to a change in the market or circumstances, most, if not all, risks can be reduced or ameliorated with good information and experience.
10. Insufficient investment in the future growth of the business. The ability to grow a business over a long term has a lot to do with the capability to do so financially. Just as we save for a well-deserved holiday or that special something we want to buy, firms need to prodigiously accumulate retained earnings to be able to develop new products or services, upgrade staff, defend a market position or expand through acquisitions.

This book attempts to address these issues, among others, using market models (built up from company level information) and benchmarking as a solution. As with any solution, it can and will work only if the problem has been identified and acknowledged. It is not possible to solve all the issues that a firm faces; however, I think addressing most of the issues mentioned will go a long way towards building and running a successful business.

Thus, if you want a way to help you gauge where your business stands compared to the best-in-class and understand what are their critical success factors, or identify future opportunities and threats to your business, then this might be the best value-for-money book you will ever find.

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HOW TO USE THIS BOOK

I have organized this book to cater to as many needs as possible. To do this, I have distilled the core issues (central to the decisions that firms make every day) into a few bold questions:

- Where are the profits being made?
- Which market is giving the best return on investment?
- Which sectors are giving the best return on investment?
- How do I spot winners?
- Where do I stand amongst the best-in-class?
- What are my strategy options?

As far as possible, each chapter has been written to be self-contained. For example, the chapter on "Sector Analysis" explains what sector analysis is, walks you through the analysis of a sector with data curated from more than 1,200 companies covering the 24 countries that, in total, account for more than 80% of the world's Gross Domestic Product (GDP).

In Chapter 1, the focus is on understanding the fundamentals — theories, concepts, methodology, approach and solution — that go into the analyses in this book. We will also introduce background knowledge on finance and the financial statements. All business leaders and managers know about the Profit and Loss (P&L) statement, the Balance Sheet and the Cash Flow statement, but for some, it might be the right time to really understand the implications of these financial statements. This chapter is not about bookkeeping and corporate finance. Rather, it is a non-financial perspective of how to interpret basic information like "Gross Profit" or "Net Profit" or "Equity".

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This can be particularly useful for non-financial managers. The background knowledge will also help you to understand the rationale behind the *Ability-Capability Assessment Model* (ACAM)™ and the *Profitable Frontier* (PF)™ frameworks, which were developed to help you analyze markets, sectors and industries.

In Chapter 2, the focus is on "Market Modelling". In this chapter, we look at fundamental techniques of building a market model of the market or sector that you are operating in. Most managers will have come across many management frameworks and theories. However, we will discuss only three common strategy frameworks, which I think are the most relevant and easy to use. The three strategy frameworks are *Porter's 5-Forces*, the *Competency (Inside-Out) Approach* and the *Value-Needs Approach* to determine competitive elements and customers. Having figured out your "market" using the strategy frameworks, you will then learn how to use the ACAM™ and PF™ frameworks for your analyses.

Chapter 3 is entitled "Market Analysis". As the name suggests, it is about learning how to analyze your (geographical) market and to identify which markets are expanding and which are not. Besides walking you through how to choose a market to expand into, this chapter also includes detailed charts of markets and the sectors within them. You can plot your company data and others (from the list of companies at the back of the book) onto the charts for benchmarking purposes.

In Chapter 4, we focus on "Sector Analysis", where we look at sectors in the whole world. To make it manageable, we have

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limited the number of "sectors" to 10. Within these 10 sectors, we delve deeper into 50 industries. As a learning example, we will study the Food and Beverage (F&B) sector using the data of more than 1,200 companies in our master database and other listed entities that are associated with the F&B sector. As with the previous chapter, I have included a lot of charts on the sectors and industries for you to use.

In Chapter 5, we look at how to spot "Winners". Essentially, we want to understand the characteristics that make companies "Winners". In the analysis, we may discover unpolished gems amongst the lot. These are the underperformers that have what it takes to be "Winners" but circumstances have prevented them from reaching that level. There will be an extensive use of the ACAM™ framework in our analysis, after which, you and your company will be able to spot potential partners and winners to invest in.

In Chapter 6, we look at the strategic options available to companies; in particular, what companies in the different states and stages of their business should be looking at. Key concepts like "Ability" and "Capability" will be put into context to help you answer important operational questions and to address (or to avoid) some of the critical causes of corporate crises mentioned earlier. For example, "Is my business model and strategy still relevant?" The answer to such a question starts with looking at how your direct competitors are doing.

In Chapter 7, we take a step back and look at the value of business intelligence and analytics and how their use has helped us to understand the market and the sectors we operate in,

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spot winners and plan and develop our corporate strategy. The application of business intelligence and analytics to develop foresight that we can act on is not restricted to large companies. In fact, it is the smaller companies that will benefit most. Business intelligence and analytics have benefitted many companies and the next step is to internalize them and make them a part of the culture and fabric of the organization.

GOING FORWARD

I have spoken to many people at different levels in an organization about the use of business analytics. Most agree on the need to have business intelligence in order to have sustainable success. However, there is always the "but" in the answer. Some of the reasons for not using business analytics include…

…we do not know how to get started

…is it about *Big Data*?

…it is too costly and we (Small and Medium Enterprises) SMEs can't afford it

…we have other pressing things to focus on

…not sure who will use it

Having been involved in the area of business intelligence for more than twenty years — including almost ten years of lecturing on the subject at post-graduate level — I can understand the reasons why so many companies, especially SMEs, are not getting more into business analytics. The irony is that they are the ones who need it most.

The need to help SMEs get good business intelligence and inject more quantitative inputs and objectivity into their

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decision-making process was one of the factors that motivated me to write this book. I firmly believe that DIY (Do-It-Yourself) business analytics is possible and everyone can have access to valuable insights to help them in their decision-making. I spent the past few years developing the concept, approach and framework to this end. With real and publicly available market data, I developed market models for analysis. The charts (those that you see in the book), were generated using only a common spreadsheet software. The key to the analysis is the concept and the framework developed for this solution. As there was clear interest in the solution, I decided to put them into a book so that more people can build up a skill that has multiple and multi-dimensional use. That was when it started to get really exciting.

As I was writing this book, I "beta" tested the concepts and frameworks in my classroom, as well as with those in business. I wanted feedback from potential users on the concepts, frameworks and analytical approach. Needless to say, the feedback was positive and invaluable. At one point, I had to tweak the structure of the already massive database, to generate some of the charts. However, it was learning how and what the analysis would be used for, that drove this project. After one presentation, one of the participants came up to me and said that she benchmarked her company's data against the industry data presented, and it gave her some things to think about. The idea of identifying companies that were worth investing in, often entered the discussion. There was a need to address this demand and as such, "Spotting Winners" became a topic on its own. The

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suggestions and ideas did not stop there. It soon evolved into one where, if SMEs or anyone, were to benefit from having good business intelligence, there was a need go beyond just teaching how to build models and interpreting them; there was a need to also provide up-to-date information for consumption. Publishing an update every 3 or even 6 months was clearly not feasible, especially since the knowledge could benefit SMEs everywhere and anywhere. Thus, the idea emerged, of a web or even mobile channel providing up-to-date data, charts and analyses, made available to the masses. A dedicated website — **www.profitstrail.com** — was thus developed to complement this book.

It has been one update, one enhancement after another. Never has writing a book been such an interesting journey. There is an interesting lesson for would-be entrepreneurs or for that matter, anyone looking to expand or grow their business; and that is, if you want to develop something meaningful, something that will benefit as many people as possible, you will need to be brave enough to put it out there and seek feedback. Products like Asana, Evernote, and many other software and games were enhanced by users and not by the people developing the product or service.

Fundamentally, this book is about knowing where one stands. It is about being clear about where you are and from there, making decisions to help you to move forward and ahead.

It is a book for everyone and anyone who is thinking about starting a business, or currently running one, or simply interested in picking winners.

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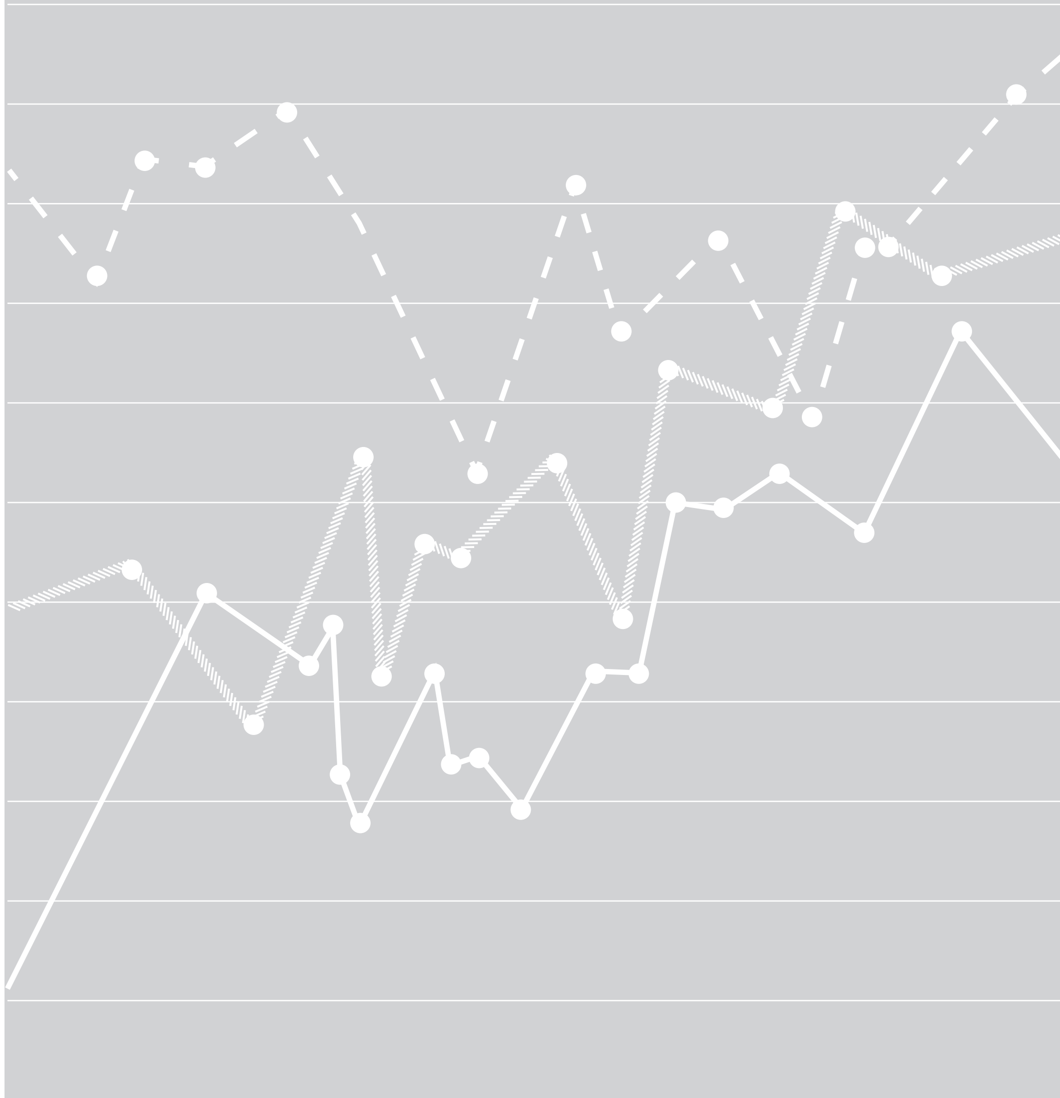
Chapter 1

The Basics



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To get the most out of this book, it is important to understand the approach used in the analyses, the methodology, concepts and frameworks. These have been employed to get the insights from which to make good decisions; decisions on which region, market, sector and industry to focus on, and also to find "Best-in-Class" companies and those with potential.

THE APPROACH

When analysing information and data, the true value comes from gaining insights at the *granular* level. The more granular the information or data we can obtain, the better will be the quality of the insights. The challenge obviously is how we should manage the vast amounts of granular information and data that we can collect.

In developing the market, sector and industry models for the analyses in this book, it was important to build a database of firm-level information that would dynamically and accurately reflect the market, sector and industry they operated in. The next step was to adopt an analytical approach that was both logical and practical. Analysis of a market, sector or industry can be done using a bottom-up or top-down approach.

The bottom-up approach, as the name suggests, would require the collation of a database consisting of a large number of companies and the information about them. It is estimated that there are more than 115 million companies in the world and this would make the bottom-up approach daunting and almost impossible. Thus, it is logical and practical to take a top-down approach for what we want to analyze. The top-down approach

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requires any analysis to start with a logical premise or hypothesis from which all other analyses can be done.

Our top-down approach begins from a logical starting point, such as using Pareto's approach and focusing on the *movers* and *shakers*, i.e. companies whose decisions and performance will impact many others. From this starting point, we have to find a common ground for comparison or benchmarking. The next logical step is to have a platform to help us understand our market, sector and industry, and then to make decisions from the insights.

The Starting Point

The core of all the analyses in this book is the premise or hypothesis that businesses today are highly interconnected through globalization, technology and relationships. Research shows that we are more connected today than ever before. What this means is that the impact of decisions and events of companies from one part of the world can have a downstream effect on a company from another. It also suggests that this impact on one sector or industry can impact another company in another sector or industry. We only need to look at how the Internet (Technology Sector, Information Technology Industry) has impacted retail companies (Services Sector, Retail Industry) around the world as evidence of this.

The interconnectedness between businesses implies that any analysis should focus on companies that have significant impact — not necessarily the best performing — on the economy, the industry they are in, the sector they belong to, and ultimately the

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market and region. The companies in the analyses should also be from countries that have the greatest impact on the world's economy. In subscribing to this hypothesis, individuals, small and medium enterprises (SMEs) will benefit from the analyses as they too will feel the impact of decisions, events and outcomes of the companies analyzed. To this end, we have selected slightly more than 1,200 public-listed companies from 24 countries. These are not just any public-listed company, they are part of the composite index of the various stock exhanges.

To better understand the approach taken in this book, let us first understand the current and future implications of the factors that have an impact on businesses today.

The 1200+ Companies

The nature of today's business is very much the result of globalization, technology development and adoption, and the changing demography. Individually, these three factors have had a tremendous impact on businesses and the way they operate. When they come together, like a perfect storm, their impact has been game changing, to say the least.

The Rules Have Changed

Globalization has made it necessary for companies to be **global-ready** whether they want to or not. Globalization has accelerated the commoditization of goods and services to the point where we can buy and sell from anywhere and to anyone anywhere. The physical boundaries that used to dictate how business is conducted have become blurred. Rules and regulations that

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used to define how business is conducted are being stretched and redefined. Business as usual is not business as before. The rapid development, adoption and deployment of technology has had an impact on the way we conduct our business, organize operations and reach out to current and potential customers. Data processing speeds have never been faster. The creation and consumption of information and data have happened at an unprecedented pace with most of the *Big Data* we hear, see and talk about, being created only in the past several years.

Growth in Consumerism

Growth in consumerism and spending, in part due to the low savings and deposit rates, have fueled global economic growth and given rise to new B2C (Business to Consumer) and B2B (Business to Business) channels. From the ubiquitous smart-phones and wearable technologies to cloud-based solutions and social media, businesses have been impacted in ways never thought of before. International phone calls can now be made at low or almost no charge; eCommerce has forced traditional businesses to change the way they do business and manage their customers; funding and financing a business is now a global exercise with the rise of crowd sourcing platforms like Kickstarter and Indiegogo.

Redefining Business Models

Even the very basic definitions of land, labour and capital have been redefined. Take the example of exhibitions and conventions. In the past, event organizers had to book hundreds of thousands

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(even millions) of square feet of space to hold exhibitions and conventions. Today, some of these event organizers have completely changed their business model and taken advantage of the Internet and the Cloud, and moved their physical exhibitions and conventions into the virtual world. The “space” they now have for their exhibitions and conventions is bigger and their reach has expanded to millions globally. Businesses can take part in these exhibitions at a fraction of the cost and participate at conferences and seminars in the comfort of their homes from across the globe. Technology has not just changed the way businesses operate but connected them on a global basis. Thus, if you think that you are safe operating your business locally, there is a need to start rethinking that business model.

Changing Demographics

The changing demographics has been happening slowly but now rapidly changing the way businesses view and engage the customer. They are a result of several factors, namely economic and population growth, the rise of the millennial generation and the mobility of persons.

Economic growth at the global level has been marked by the shift in the global economic centre from the West to the East. Economic growth and expansion have been fueled by the growth of countries like Russia, China, India and those in South-East Asia. This is evident at the international level where the new growth countries are asserting their economic might in the area of funding and financing, through the establishment of the BRICS’ (Brazil, Russia, India, China & South Africa)

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New Development Bank (NDB) and the China-led Asia Infrastructure Investment Bank (AIIB). Both these initiatives will impact the existing world order.

When we go granular and assess the markets at the city-level, we can find cities like Shanghai (China) and Mumbai (India) that have a GDP per capita equivalent to those in Europe and the Americas. With economic growth there is a natural growth in population, consumerism and education levels. Even major cities like Tokyo are having to grapple with the growing influx of people from the other cities. The gravitation towards cities is continuing unabatedly.

The Millennium Generation

The millennium generation is growing up and living in a world where technology and wealth are in abundance. They are a generation that has grown up in a globalized world where the economic and political boundaries are blurred. They are fundamentally different from the Generation X (in their 50s), Baby Boomers (in their 60s) and Traditionalists (in their 70s). Their views of work, life, business and recreation are different. Today's businesses — still run by many in their 50s and 60s — need to adjust and adapt to this new generation. For the first time, aided by the longevity and healthier lifestyles, we will see four or even five generations working in one organization.

One of the millennium phenomena taking place is the demographic shift of these millennials to the cities. They are moving out from the suburban and rural areas and into the cities. Capital and secondary cities are burgeoning (some to the

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point of breaking) with the new influx. So much so that when discussing economic development, it is not sufficient to assess economic development at the country level but there is a real need to look at cities as well. There is now a website dedicated to this where there is even a ranking of the "World's Most Youth Friendly City" — Toronto was voted tops in 2014.

Within this context, the approach for the market and industry models was developed for this book. The starting point is that globalization, technology development and adoption, and the changing demography have resulted in businesses being highly networked. There are very few, if any, businesses that are isolated from events and outcomes at the global level. The approach was thus to track and focus on the movers and shakers of the world. Some 1,200+ public-listed companies from 24 countries that collectively account for more than 80% of the world's GDP of more than $77 trillion, will go into the master database for all the analyses. The 24 countries are:

- US – 22.44% (of world GDP)
- China – 13.34%
- Japan – 6.15%
- Germany – 4.92%
- France – 3.74%
- UK – 3.67%
- Brazil – 2.89%
- Italy – 2.74%
- Russia – 2.65%
- India – 2.64%

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- Canada, Australia, South Korea, Spain, Mexico, the Netherlands, Indonesia, Turkey, Saudi Arabia, Switzerland – 14.73% (collectively)
- ASEAN countries of Singapore, Malaysia, the Philippines and Thailand – 1.64% (collectively)

The 1,200+ public-listed companies, though making up only about 3% of the total number of public-listed companies in the world, are representative of the market and sector they are in. These companies are the main composite companies of the major stock market indices. Other reasons for choosing to focus on public companies are:

- The information curated is publicly available to everyone.
- The quarterly reporting and publication of these results provides up-to-date data for analysis.
- The data used is quantitative as opposed to being qualitative (e.g. feedback obtained through surveys).
- The veracity of the data is sound.
- Built into the reported data are corporate governance and accountability of the management of those companies.

A sample of the major indices that these companies belong to are:

- US – Dow Jones, NASDAQ 100, NASDAQ Composite
- China – Hang Seng, FTSE China 25, Shanghai Composite
- Japan – Nikkei 225
- Germany – DAX-30, DAXTech 100

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- France – CAC-40, CAC Large/Mid 60
- UK – FTSE 100, FTSE 250
- Brazil – BOVESPA-70
- Italy – FT MIB 40
- Russia – MICEX-50
- India – BSE Sensex-30, CNX Nifty-50
- Others – S&P TSX (Canada), S&P ASX (Australia), KOSPI (South Korea), IBEX (Spain), IPC (Mexico), AEX (Netherlands), IDX Composite (Indonesia), BIST (Turkey), Tadawul All Share (Saudi Arabia), SMI (Switzerland), STI (Singapore), FTSE KLCI (Malaysia), etc.

Even though the core database is made up of 1200+ public-listed companies, the analyses have implications even for SMEs and those intending to start a business. For example, most, if not all, SMEs play a supporting role in the broader supply chain. That is to say, they will provide a technology, product or service to another company that might then incorporate it into a process, module or part and sell it onwards, and so forth. The performance of the producer of the final product or service will have a cascading impact on the performance of that SME at the start of the value-chain. Thus, even though your business might seem insignificantly small when compared to the more than 100 million companies around the world, what impacts the movers and shakers at the top will have an impact on your current and future business.

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Basis of Comparison

Building market and industry models that mirror the value-chain we are in is not difficult (more on this in Chapter 2). However, we need to be able to have a basis for comparison; one where we can compare companies of different sizes, from different industries and in different geographical locations.

To do this, we must focus on the common thread that links all of them together, but at the same time acknowledge each company's uniqueness (the source of their *absolute* advantage), abilities (the source of their *competitive* advantge) and capabilities (the source of their *comparative* advantage).

The one common thread that binds all companies togther is the way they report their performance. The Profit and Loss (P&L) statement (or Statement of Comprehensive Income), Balance Sheet (or Statement of Financial Position) and Cash Flow statements are documents that all companies produce, whether they are privately-held or public-listed, small or large. To most of us, these financial statements are a lot of numbers that do not seem to tell us much, beyond their profitability and if they are a going concern (in business terms it means that the company has the resources needed in order to continue to operate indefinitely).

In reality, the accounts of a firm can be quite the tale. When the financials are produced, the objective is to report to the stakeholders the performance of the company; what it has done and how it was done. There are other aspects of the business that do not readily show up in the financials, and these are accounted for in the annual reports. For example, the business strategy, the

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analysis of the operating environment and the strategy going forward. To some extent, companies use financial ratios to link the strategy, operations and reported figures. For example, profit margins, inventory turnover ratios, liquidity ratios, etc.

However, to the many who still struggle to make sense of all of these, there is yet another way. Having taught finance to non-finance managers, reviewed hundreds of financial and business plans, started and run businesses, and received feedback from many about what concerns them most about their business, I have distilled it into two fundamental concepts that assess how a business has performed vis-à-vis the competition and what is the relative strength (or weakness) of a company vis-à-vis another. The two approaches have resulted in two new analytical frameworks — Ability-Capability Assessment Model (ACAM)™ and the Profitability Frontier (PF)™ model. The two approaches make use of only three pieces of information from a company's financials, namely *Net Profit (Net Income), Shareholder's Equity* and *Number of Employees*.

Gross Profit, Operating Profit and Net Profit (Net Income)

What is the significance of the "Net Profit" number? To understand its significance, especially in many businesses today, we need to first understand the P&L and what it tells us (assuming that most of us are not financially literate). In a typical P&L, we will see three sets of "Profit" numbers. They are the Gross Profit (GP), Operational Profit (OP) and Net Profit (NP) numbers (See Chart 1.1).

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Chart 1.1: Profit & Loss Statement
(Consolidated Income Statement)

	Revenue/Sales
(-)	Cost of Sales
	Gross Profit/Loss
(-)	Selling & Distribution expenses
(-)	General and Administrative expenses
(+)	Other operating income and gains
(-)	Other operating expenses and losses
	Operating Profit/Loss (PBIT)
(+)	Interest income
(-)	Interest expense
(+)	Profit from investments
(-)	Income taxes
(+)	Income from discontinued operations
	Net Income/Loss (PAT)

The Gross Profit, even for companies in the same industry and of the same size, can be different. The difference in the GP is due to the "Cost of Goods or Services". Companies pay different prices to suppliers for a number of reasons, such as volume (or quantity), supply conditions, timing (or urgency), relationship (with the supplier), etc. Obviously the higher the GP, the better it is. The GP thus gives us a first glimpse into the company's operations. It also gives us an idea about the relationship the company has with the supplier and its ability to source efficiently.

The Operating Profit is the result of Gross Profit minus Operational and Non-Operational Costs. It tells us how well the company is run. It gives us a view of the management as well as the productivity and efficiency of the employees to generate value

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for the organization. These are the cost items that companies look to trim, when times are bad and will increase, depending on the business strategy and situation, e.g. increasing advertising to get more sales or promote a new product, increase in salaries as a result of bringing in new talent, or increase in training costs to upskill employees.

The Net Profit (NP) of the firm is derived from the Operating Profit minus Tax Payable plus Net Revenes/Gains from investments made. A firm's net profit margin (NPM) is the Net Profit divided by the Revenues. The net profit number has become more important these days as firms are now "hedging" their performance through investments in other companies. There are quite a lot "extra-curricular" activities, as companies seek to invest accumulated funds to get better returns. Not all investments pay off, obviously, and this can impact the NP figure. The NP figure thus gives us a good idea of how the company as a whole manages its relationships, runs the business and invests its resources. Thus the reason to focus on the Net Profit number and not the other profit numbers.

Total Assets, Total Liabilities and Shareholders' Equity

There is a reason why the Balance Sheet is also called the Statement of Financial Position. The Balance Sheet helps us to understand something about the health of the business. There are three important pieces of information from the Balance Sheet that anyone looking at a company's financials must note, and they are the *Total Assets*, *Total Liabilities* and *Shareholders' Equity* numbers.

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The Total Assets of a business are those that are of value and which can be liquidated for a value. Good assets are those that create value for a firm. As assets lose their value over time, it is important that they are put to good use during their productive life. Assets are classified into two types — current and long-term. Current assets are those that can be converted into cash in twelve months or less. Examples include cash, short-term investments, account receivables (e.g. what is owed to you by customers) and inventory. The management of current assets is fundamental to the operating success of a business. This is where the vital operating assets are found, those that drive the day-to-day activities of the company.

Long-term assets are those that take longer than twelve months to convert to cash. Fixed assets are an example of long-term assets. These are assets that are owned by a company, which contribute to the company's income but are not consumed in the income generating process and are not held for cash conversion purposes, e.g. a factory building. Fixed assets are tangible items usually requiring significant cash outlay and last for an extended period of time.

There is also a class of assets called *intangible assets*. These are things of value that cannot be physically touched, e.g. trademarks, patents, copyrights and goodwill. For some businesses, like those in the technology, FMCG (Fast Moving Consumer Goods) and retail sectors, intangible assets can be significant. The total asset value of a firm can give you an idea of the firm's business focus and its use of technology.

The Total Liabilities of the firm concerns the obligations the

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firm has, to transfer something of value to another party, e.g. payments for products and services. Just like assets, there are long-term and short-term (or current) types. As an example, overdrafts (OD) is a short-term liability whilst loan repayments for the purchase of an asset are long-term liabilities. The obvious objective of any firm is to have total liabilities that are less than total assets.

The Shareholders' Equity includes two pieces of important information — the amount of money invested in the business and the retained earnings (from net profits earned from the business). The amount of shareholders' equity in a business is a very important number. When the shareholders' equity is *negative*, the company is *insolvent* or technically it has no more funds to be a going concern. Thus, it is fair to say that the higher the shareholders' equity amount, the better off the company is. Having a large war chest has its benefits. For example, it puts the company in a good position to go after opportunities without having to borrow funds. It also sends a message to the competitors that it can defend itself against any "attack".

However, companies also need to consider how to reward stakeholders for their support, and this is done through dividends. Businesses need to balance this well as being in a position of strength is just as important as having good and supportive stakeholders. The amount of shareholders' equity contributes to the perception of a company being either "strong" or "weak".

Number of Employees

The "Number of Employees" figure is used to normalise the Net Profit and Shareholder's Equity figures and allows us to compare

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across industries and markets. This approach is not uncommon, e.g. you might have come across the Net Profit per Employee (NP/Emp) ratio as a measure of productivity in investment websites and reports. By using the employee number as the divisor, we essentially remove "size" from the equation. This illustrates that firms can be large with a lot of employees, but when it comes down to efficiency and productivity, the contribution of each employee to the value created in the company can be low compared to smaller competitors.

To make any sensible or logical comparisons between companies, we need to put the key pieces of information with regard to a firm's *ability* to make profits, and its *capability* to take necessary actions when opportunities or threats come to the doorstep. The two analytical frameworks — Ability-Capability Assessment Model (ACAM)™ and the Profitability Frontier (PF)™ model — do just that.

Market Model Frameworks

An important role of frameworks and analytics is to provide decision-makers with as much objective and quantitative inputs as possible. A firm makes many decisions during the course of a year, a month, even a day. Decisions can be made during weekly or monthly meetings, strategic planning days or events, etc. However, there are probably two things that will trigger the need to find solutions and options as quickly as possible. They are (1) when the margins have declined, narrowed or fallen into negative territory, and (2) when the company has become too big and unwieldy.

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When margins decline, narrow or fall into negative territory, firms will look at several options; (1) Reduce costs, (2) Increase Yields (not Revenues), (3) Streamline products and/or service offerings and focus on high margin segments, (4) Find new markets with higher margins for existing products and/or services or (5) Go for Scale or Scope economies usually through acquisitions or mergers. All of these will take time, have different risks attached and attract one reaction or another. If there were a need to prioritize the five options according to the time needed for implementation, it would look something like this:

1. Streamline product and/or service offerings. Looking at data from the firm's transaction database and factoring volume and margin, it is possible to phase out products or services that are not bringing in the margins but taking up costs.
2. Increase yields, e.g. reducing the cost to serve a customer for a product or service; using technology to allow customers to order using an iPad instead of having waiters tend to each table. A productivity increase is implicit in this strategy.
3. Find new markets, local or overseas. This can be done through targeted advertising, product differentiation, bundling, etc.
4. Reduce costs. I rank this as taking more time as it is never easy nor is it pleasant to start talking about downsizing or reducing remuneration and benefits. This should be considered when (1) – (3) have been exhausted.
5. Consider mergers or acquisitions. This takes time and

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resources, and not to mention being in the position to control the deal e.g. Facebook acquiring Whatsapp for $19 billion (2014); Microsoft acquiring Nokia for $7.2 billion (2014); and FedEx acquiring Europe-based TNT for $4.6 billion (2015).

When a firm gets too big and unwieldy, and even less profitable as a group, (e.g. having gone through a period of capability building, expanded too quickly or having gone through an acquisition frenzy), it might be time to look at a medium to long term strategy to become flexible and responsive to the markets again. Some of the options available include: (1) Breaking up the company along geographical or competency dimensions whilst still keeping ownership, (2) Spinning off or Divesting subsidiaries, divisions or units, (3) Reducing or Redeploying manpower and resources to improve yield, (4) Increasing productivity or (5) Closing business units, divisions or subsidiaries. If there were a need to prioritize the options based on time needed for implementation, my ranking would be:

1. Increase productivity. The company in this situation would likely be able to look at its processes and structure and invest in technology, upgrade systems and controls, to improve profitability as well as trim off the excesses that are causing the company to be unwieldy, less profitable and slow in response.
2. Reduce or Redeploy manpower and resources. The root cause of the firm being in the position that it is in, might not be about having too many employees, but rather

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about keeping up with changes that are happening in the market and industry and that could mean the need to retool, recharge and redeploy staff to where they can contribute the most. Any cuts in manpower should be made at the last resort.

3. Break up the company along geographical or competency dimensions whilst still retaining ownership. This has been a challenge that many multinationals (MNCs) face today. Even with companies that have had overseas presence, having the higher management centralized at the Headquarters (HQ) can make an organization look bureaucratic and conservative. Companies can push out some of these higher management functions to the region and that would increase the responsiveness of the firms. For example, HP splitting up into two companies, one focusing on the computer and printer business and the other on corporate hardware and services business. In the process 5,000 jobs were lost.
4. Spin off or divest units, divisions or subsidiaries. There is a need to be thorough in making this decision. Just like in M&As (Mergers and Acquisitions), due-diligence must be done to ensure that the right parts of the company are spun off. A wrong decision could drag the company down even further. For example, Wendy's selling off Arby's for $430 million (2011); and GE selling off its real estate assets and much of GE Capital (2015).
5. Close the unit, division or subsidiary. There is certain finality about such an action. Any closure would mean

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that many people would lose their jobs, assets will have to be written off (or sold), existing relationships with customers and suppliers will cease, etc. Making the "transition" can be just as difficult as taking on a new set of employees through an acquisition.

Each of these options needs to be based on information that is credible, verifiable and current. It is thus important that these and many other smaller decisions are based on objective inputs as far as possible. For example, would you plan a market entry strategy based on inputs that say "the market is highly profitable" or "the median net profitability of the companies operating in the market was 8.5% in 2014 and this has been increasing for the past 3 years where the median net profit has been 5.5% in 2012 and 7.0% in 2013."?

However, there is not much business intelligence that is quantitative and also predictive in nature. Many decisions are probably made based on less than perfect information. The ACAM™ and PF™ frameworks were developed to increase the amount of objective and quantitative business intelligence for a company to use, in order to make these decisions. Using reported financial data from major public-listed companies to build the market and industry models, tangible numbers appear. What's more, the charts exhibit certain "shapes" and "patterns" formed from the scattering of the plotted points. These "shapes" and "patterns" allow you to analyze the economic situation and possibly even predict the behaviour of companies along the options mentioned above. What is even more useful, is that what

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you are "seeing", is what the companies in their predicament are facing and seeing. Through simple extrapolation, you might be able to guess the annualized data that would be out in three to six months' time.

Here are some of the insights that you can get from the ACAM™ and PF™ frameworks:

- Markets, sectors, industries and companies that are obtaining higher net profits, and those that are not.
- Markets, sectors, industries that are expanding versus others that are not.
- Sectors and industries with high or low barriers to entries and where the firm-level resistance will be coming from.
- Sectors and industries with high concentration (few dominating firms) and those that are highly competitive.
- Sectors and industries that are fragmented and those that are not.

Elements of the ACAM™ and PF™ Frameworks

The charts are plotted using the following company data:

1. Net Profit or NPAT (Net Profit After Tax)
2. Shareholder's Equity
3. Total Revenue (Sales)
4. Number of Employees

From the four pieces of information, we will compute the following and plot them accordingly. These plotted points are:

- (1) ÷ (4) → Net Profit / Employee
- (2) ÷ (4) → Equity / Employee

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- (1) ÷ (3) → Net Profit Margin (NPM)
- (1) and (3) → % change in Revenue and % change in Net Profits

The median lines for both frameworks are plotted in to divide the chart into four quadrants.

The Ability-Capability Assessment Model (ACAM)™

The ACAM™ is one method that companies can use to benchmark themselves against the "best-in-class" and against a firm's direct and indirect competitors. ACAM™ plots the companies' Net Profit per Employee (NP/Emp) and their Shareholder's Equity per Employee (E/Emp) figures (see Figure 1.1).

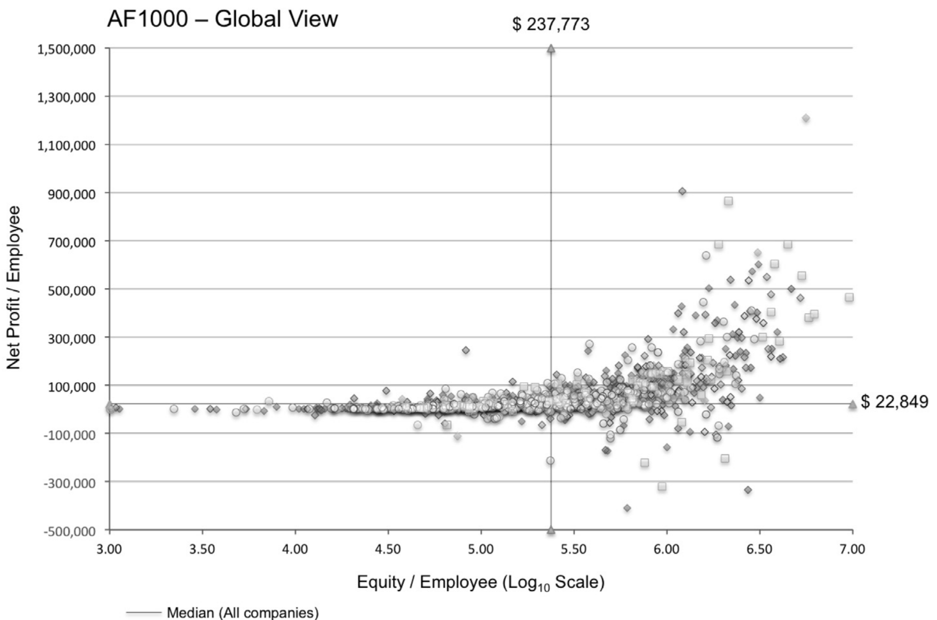

Figure 1.1 ACAM™ Example

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By calculating the market or industry median NP/Emp and E/Emp, one will be able to identify which companies are performing above the market or industry with regard to the ability (NP/Emp) and capability (E/Emp). Furthermore, by introducing the 90th percentile lines for NP/Emp and E/Emp, we can identify the "best-in-class" companies. Typically, the "best-in-class" companies (see Figure 1.2), in any market or industry represent the top 6-8 percent.

The implications of being in the different segments will be explained later in Chapter 6. There, we will look at some of the "best-in-class" companies and also explore some of the actionable strategies that firms can consider as they move towards being the "best-in-class".

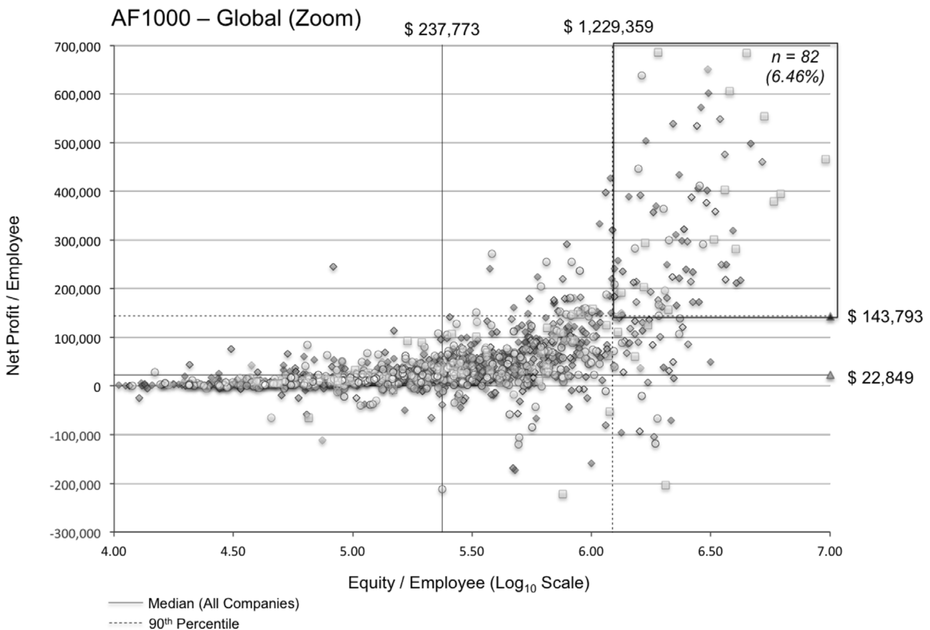

Figure 1.2 ACAM™ (90th Percentile)

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Profitability Frontier (PF)™

The objective of the Profitability Frontier (PF)™ is to gain insights into the the *Profit Pools* at the Sector and Industry levels. The PF™ chart plots the relative change of a company's revenues and net profit from the previous year to the current year. By comparing companies in the same sector or industry, we can analyze how companies make profits or losses. We find companies in a position where there is an increase in revenues but with their profits reduced. On the other hand, there are those that have reduced their revenues and yet made better profits, e.g. through efficient use of manpower and technology, and refocusing efforts on higher margin segments. By introducing the median for Revenue Change (YoY) and Net Profit Change (YoY), we can group the performance of companies into four types (see Figure 1.3).

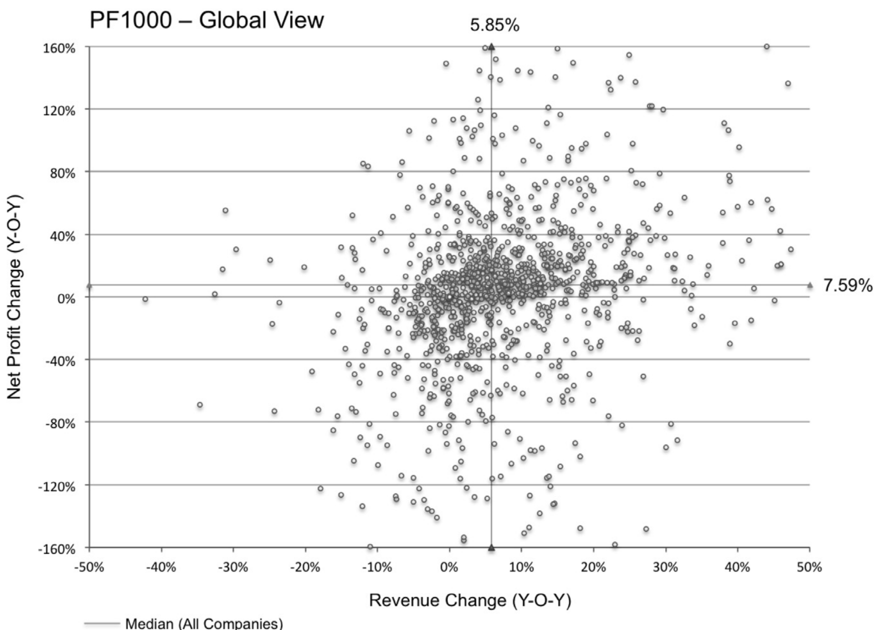

Figure 1.3 – PF™ plot

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The underlying value of the PF™ analysis can be seen when we go granular. For example, Figure 1.4 plots the relative movement of the North Asian markets — China, India, South Korea and Japan. The chart tells us that the North Asian market median is better than the global median indicating that in 2014, the bouyant North Asian market was a major contributor to the global economic growth. A closer analysis shows that South Korea was the North Asian laggard with Japan, India and China leading the growth in that region.

By drilling down even further to the company level, we can see a picture of how profitable the individual companies were and who has been leading the growth in the region (see Figure 1.5).

From the distribution, it is clear that Japanese companies were

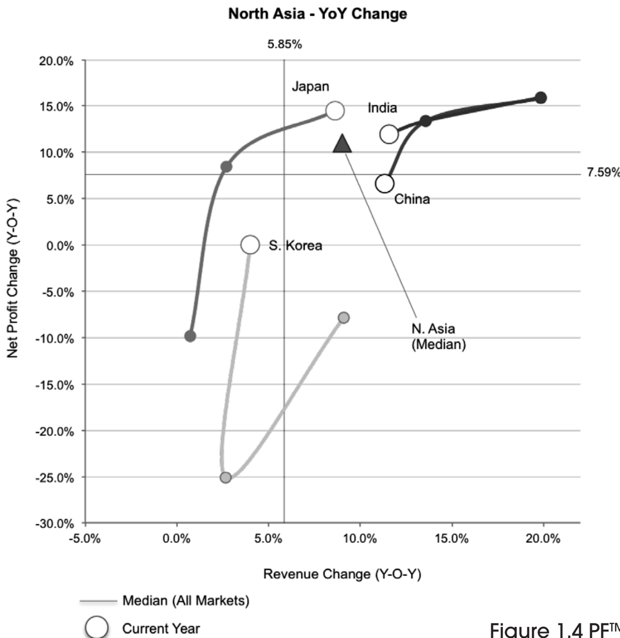

Figure 1.4 PF™ – North Asia

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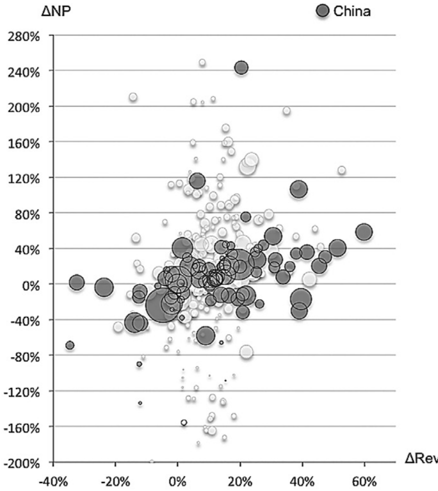
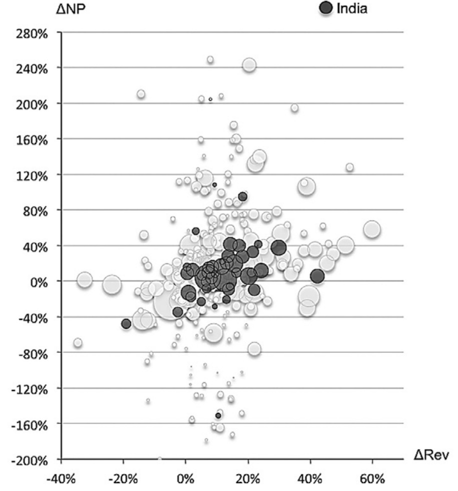
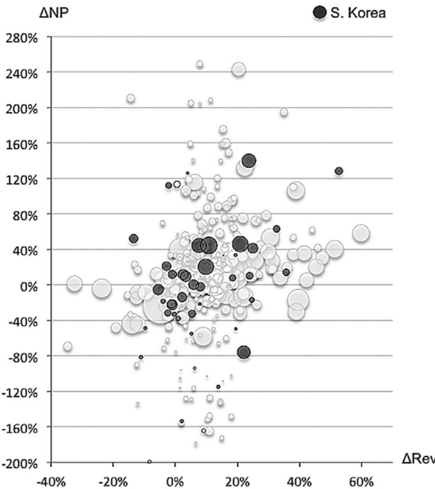
making more profits in spite of smaller revenue growth. Chinese and Indian companies were seeing more growth in revenues than net profits. The implications will be explored in later chapters.



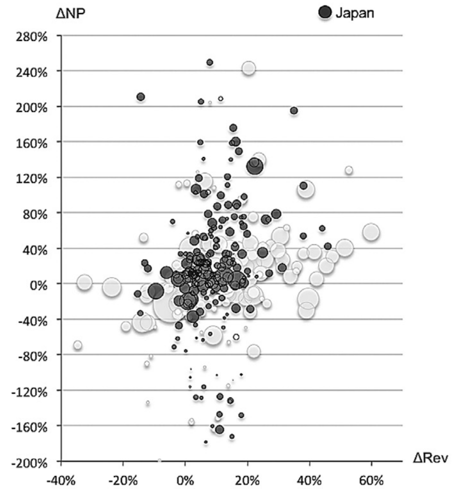
NB: Size of bubble = Relative NPM of company to others.



NB: Size of bubble = Relative NPM of company to others.



NB: Size of bubble = Relative NPM of company to others.



NB: Size of bubble = Relative NPM of company to others.

Figure 1.5 PF™ – North Asia Market

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The Quadrants

The median lines serve to divide the market, sector or industry into four quadrants (see Figure 1.6). Each quadrant tells a different story and a possible strategy.

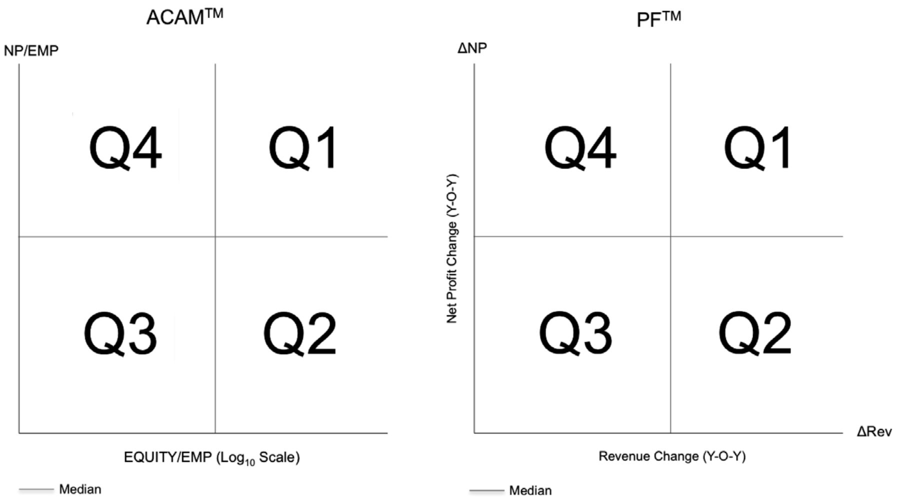

Figure 1.6 The 4 Quadrants

The main focal point is on (1) the spread of the scatter plots, and (2) the companies, industry or sector that are in quadrants Q1 and Q3 of both the frameworks. The interest in these two quadrants is obvious. Quadrant Q1 contains those that beat the global, sector or industry median for both metrics, while quadrant Q3 contains those that did not. Companies in quadrant Q3 are considered "weaker" than those in quadrant Q1 and the further apart they are on both axes, the lower the capability of the firm and their ability to create value. Our interest in companies in Quadrant Q2 lies in their ability to create value (profits) despite

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achieving lower turnover. Central to their success is the ability to increase productivity or reduce cost.

Market Models

The market, sector and industry models seen through the ACAM™ and PF™ lenses help you to do a number of things. In particular, they allow you to:

- Identify which regions and markets are growing and could provide opportunities for your business;
- Identify which sectors and industries are growing and which are fading;
- Spot the "Best-in-Class" and potential "winners" from a sea of companies; and
- Build your own market and industry model for planning and strategy purposes.

We have developed a website to complement this book and its analysis at **www.profitstrail.com** and that is where you can find up-to-date market and industry models, and even create your own. Through the curation of data on more than 1,200 companies from 24 countries that contribute more than 80% of the world's GDP, we are able to provide you with foresight that is actionable.

Analyzing the Charts

In analyzing the ACAM™ and PF™ charts, we are interested in two things — where the plots are (i.e. which quadrant on the chart) and their dispersion (i.e. how are the plots spread out). This applies to charts about the market, sector or industries.

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For example, at the highest macro level, in which region, grouping or bloc is the best performing? Figure 1.7 shows the median revenue and net profit change for Advanced Economies, Europe, BRIC (Brazil, Russia, India and China) and Developing Economies — against the World median.

The "World" median is the median of the 1,200+ companies from the 24 countries that contribute 80% of the world's GDP output. In 2014, the median changes in revenues and net profits were 5.84% and 7.61% respectively. The change-path for the World median shows that in terms of profitability, companies on the whole have been doing better. Change in year-on-year (Y-O-Y) median profitability has increased from 3.04% (2012) to 4.58% (2013) to 7.61% (2014). This is despite the dip in revenue growth from 2012 to 2013 and rebound in 2014. Revenue growth numbers tell us about how the world is expanding (it tends to mirror the Gross World Product (GWP) trend) whilst the net profit growth numbers tell us how efficient and effective companies have been performing.

The same inference can be made with regard to the four major groupings; Advanced Economies (X=4.89%, Y=8.13%), Europe (X=2.057%, Y=-0.85%), BRIC countries (X=11.59%, Y=6.14%) and Developing Economies (X=10.01%, Y=6.14%). Only Advanced Economies is enjoying higher Net Profit growth than the rest of the world. In terms of Revenue growth, BRIC and Developing Economies hold the key to economic growth. We can go one level down to see which countries fall into which quadrant (see Figure 1.8).

Using the World median for reference, the countries with

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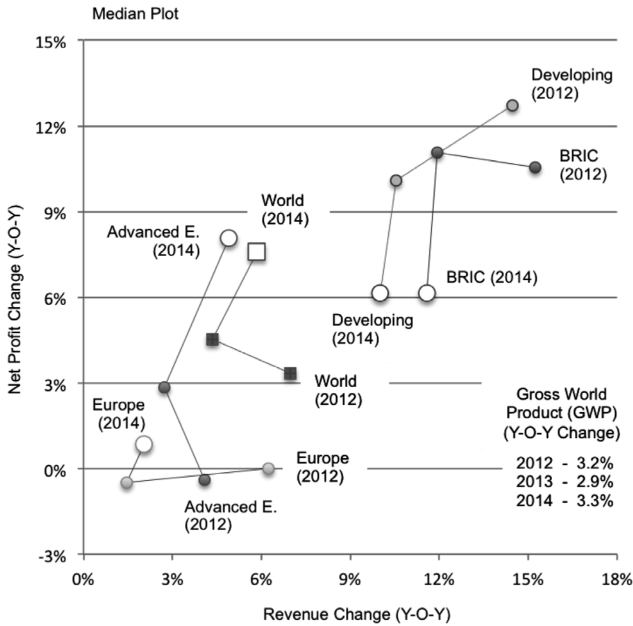

Figure 1.7 Major Grouping vs World

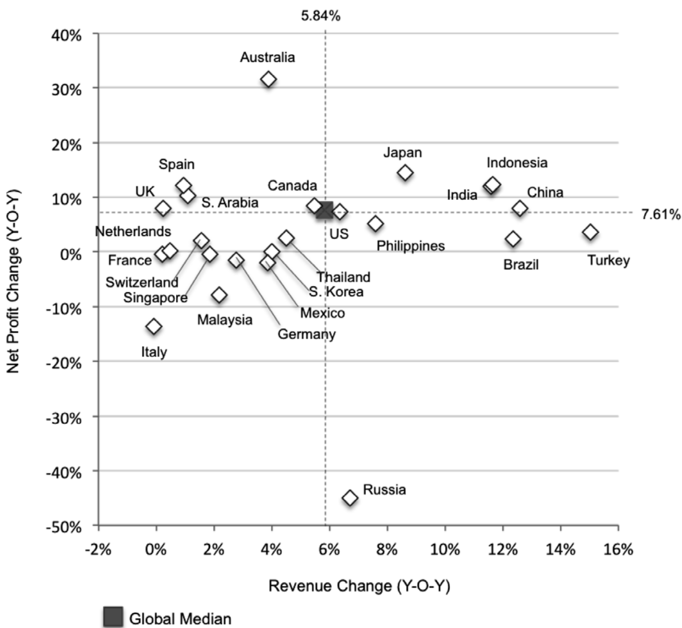

Figure 1.8 Country-Level Analysis

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both the net profit and revenue change medians higher than the world's median are Japan, India, Indonesia, China and the US (only just). That is to say, based on financials filed by companies from these countries, at least 50% of the key companies in these countries are outperforming those from other countries.

On the flip side are countries that fall in the quadrant where *both* the net profit and revenue change medians are below that of the world's median. In 2014, more than 45% of the countries we were tracking fell in this quadrant. However, these countries' combined GDP was only 20.89% of the total world output. Five of them are from Europe (including powerhouses Germany, France, Italy and Russia), four are from Asia (three from South-East Asia) and one from Latin America.

From Figure 1.8, it is quite obvious that the more attractive markets will be above the Net Profit Change median line (7.61%). How do we choose? Can we tell which sector is doing well and in which market? Figure 1.9 and Figure 1.10 give an example of the industries that are doing well in Japan and in India. From the chart, we can infer a few things. First of all, the median profitability growth is about the same, however the revenue (or market share) growth potential in India is better than Japan. Secondly, the sectors in Q1 are also different. In Japan, the sectors doing well are Technology, Consumer, Basic Materials and Energy, whilst in India the sectors that are doing well are Technology, Financial and Healthcare. Thus, depending on which sector we are in, our choice of which market to enter becomes clearer.

However, firms have limited resources and thus must make a choice of which market to enter. Before deciding to enter a

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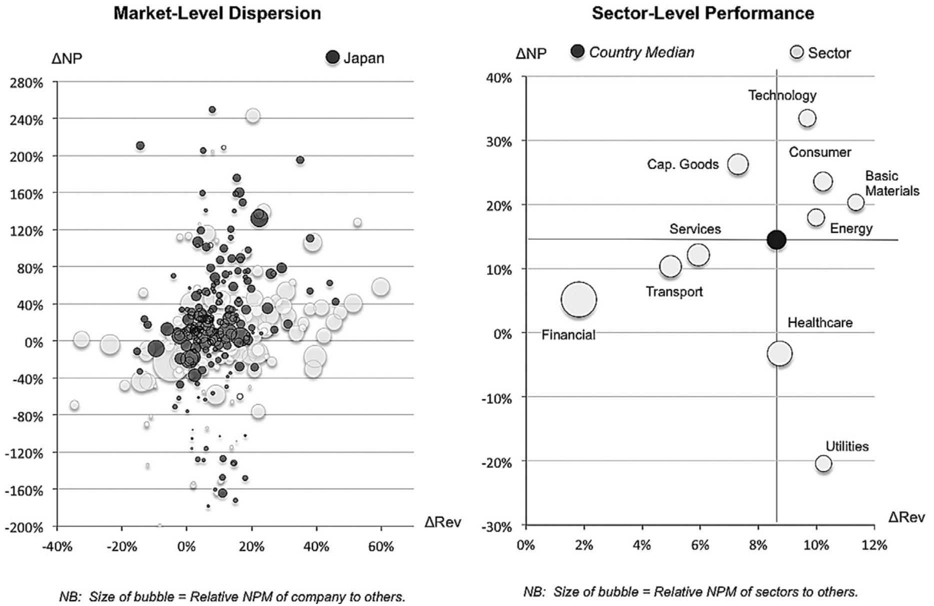

Figure 1.9 Japan Market

market (or sector or industry), companies will assess three things. They are the ease of entry, the costs of doing business and the potential to make profits.

The barriers to entry are one of the first things that a firm must assess before considering the impact of costs and profit potential. Barriers to entry refer to any obstacle — real or perceived — that prevents a firm from entering the market, sector or industry. These include high start-up costs, government legislation and tax benefits. There are also naturally occurring barriers, such as shortage of skilled workers, advantages accorded to incumbents (economies of scale and scope, access to resources, etc.). Traditional sectors with high barriers to entry are those that require a large capital base, such as transport (airlines, rail and water transport, etc.) and utilities (oil, gas, electricity, water,

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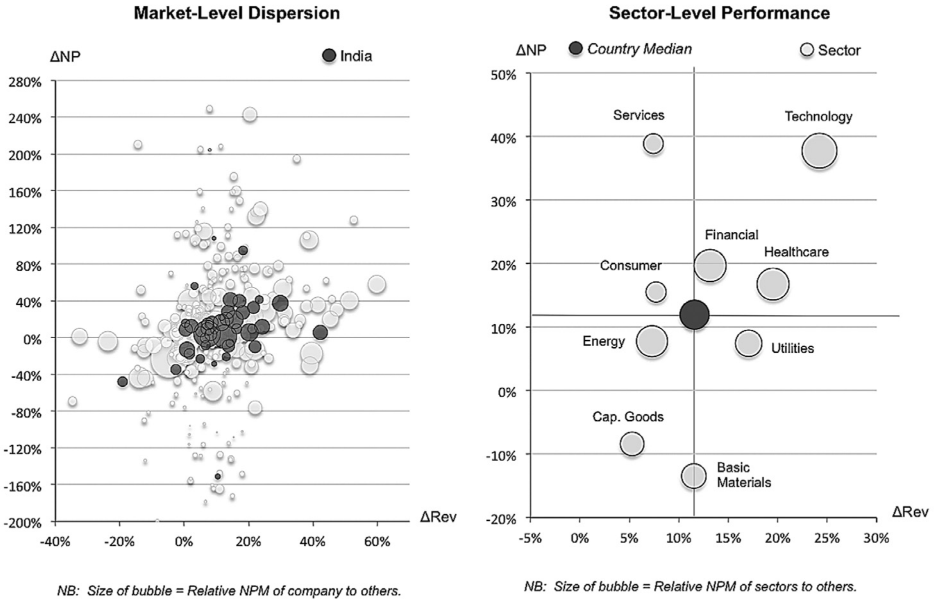

Figure 1.10 India Market

etc.). Traditional industries with high barriers to entry include aerospace, broadcasting, telecommunications, semiconductor, real estate and automotive.

However, with globalization and advancement in technology, the prohibitive start-up costs of some of these industries have come down. For example, the Internet has been a game changer for the telecommunications and broadcasting industries. International phone calls can now be made cheaply through VOIP (Voice Over IP), WhatsApp, Skype and other platforms. Social media has become a broadcasting platform where the world is getting news (via Twitter and Facebook) even before it gets to print or television. The giants of automobile manufacturing — US, Japan, Germany, France and the UK — do not have dominance over the industry any more. In 2013, more than 80 million vehicles

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were produced and the share of China (25.4%), South Korea, India, Brazil and Mexico has risen to 43%, while the share of USA (12.7%), Japan, Germany, France and UK has fallen to 34%.

The costs of doing business have been falling. The use of technology in many businesses has driven costs down. Furthermore, the cost of doing business has taken on a new perspective with the focus now not on fixed or variable cost, but on total cost and the cost-to-serve. What this does is shift the focus to productivity and increasing yield as opposed to being constrained by budgets and limits on use of resources. The bottom line is the amount of profits earned.

The potential for profits has a lot to do with a firm's ability to make it happen. A company can be in an industry that is achieving 20% net profit margins, and yet not make anything close to that. How the company uses its resources, its productivity and innovativeness will contribute towards its ability to take advantage of a positive situation.

Despite the importance of having up-to-date information on the three decision factors, which are not static, there isn't a platform to get at all the information. The ACAM™ and PF™ sector and industry charts and analysis plug the gap in many ways. Using firm-level data on the key drivers of the three decision factors — revenues, net profits and shareholders' equity — the frameworks can help quantify some of the general descriptions of a sector or industry, namely:

- The competitiveness
- Profit pools and Profit potential
- Concentration and Fragmentation

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- Entry barriers
- Growth levels

By analyzing the dispersion of the plots and the comparative size of the Net Profit "bubbles", we can make a number of inferences about the sector and industry. By observing the way the dispersion changes over time, you will be able to see how the sector or industry is developing.

The Dispersion and its Implications

There are four dispersion patterns for the PF™ (see Figure 1.11) and three patterns for the ACAM™ (see Figure 1.12) that will help in the analysis of the market, sector or industry. The four dispersion patterns associated with the PF™ charts are:

A. Tight Cluster. Within the context of industry and sector analysis, the industry is quite homogenous in that they are typically engaged in a similar business model with quite similar cost structures. When clustered in a tight formation, the companies typically experience similar fortunes, e.g. in terms of revenue and profit growth. It is possible to make better profit margins, however differentiation is limited. It is not uncommon to find quite a number of well-established incumbents and the barriers to entry into such industries can be high, not just because of the high start-up or capital intensive costs, but the actions of the incumbents can also keep out competitors. Within the context of markets (i.e. country level), the clustering of companies from different

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industries in this form usually indicates the dominance of a few sectors in the country, e.g. resource-rich countries like those in the Middle East, or markets that are relatively protected and less open, e.g. India. Such markets have a high barrier to entry.

B. Loose Cluster. A loose cluster plot typically describes an industry that is fragmented and one where product and service differentiation can make a difference. A fragmented industry is one that has no major players. The businesses tend to be small, and business practices vary widely because individual owners use individual methods. That does not mean the industry is small, like the retail (food, non-food, specialty) industry.

   A fragmented industry can be quite robust. All of these factors together can present you with advantages for your small business. The barrier to entry is typically lower. From a market perspective, such dispersion typifies markets that are highly diversified, i.e. there are many industry segments with many companies in each segment. The markets are usually large, such as US, China, Brazil, UK, etc. However, it is not the size that defines the diversification, but the performance of the various sectors tends to be highly spread out as well. Diversified economies are usually more resilient and offer more opportunities to companies seeking to break into the market.

C. Horizontal Cluster. The horizontal (flat) plot is a variation of the tight and loose dispersions observed. The horizontal spread indicates that companies in the

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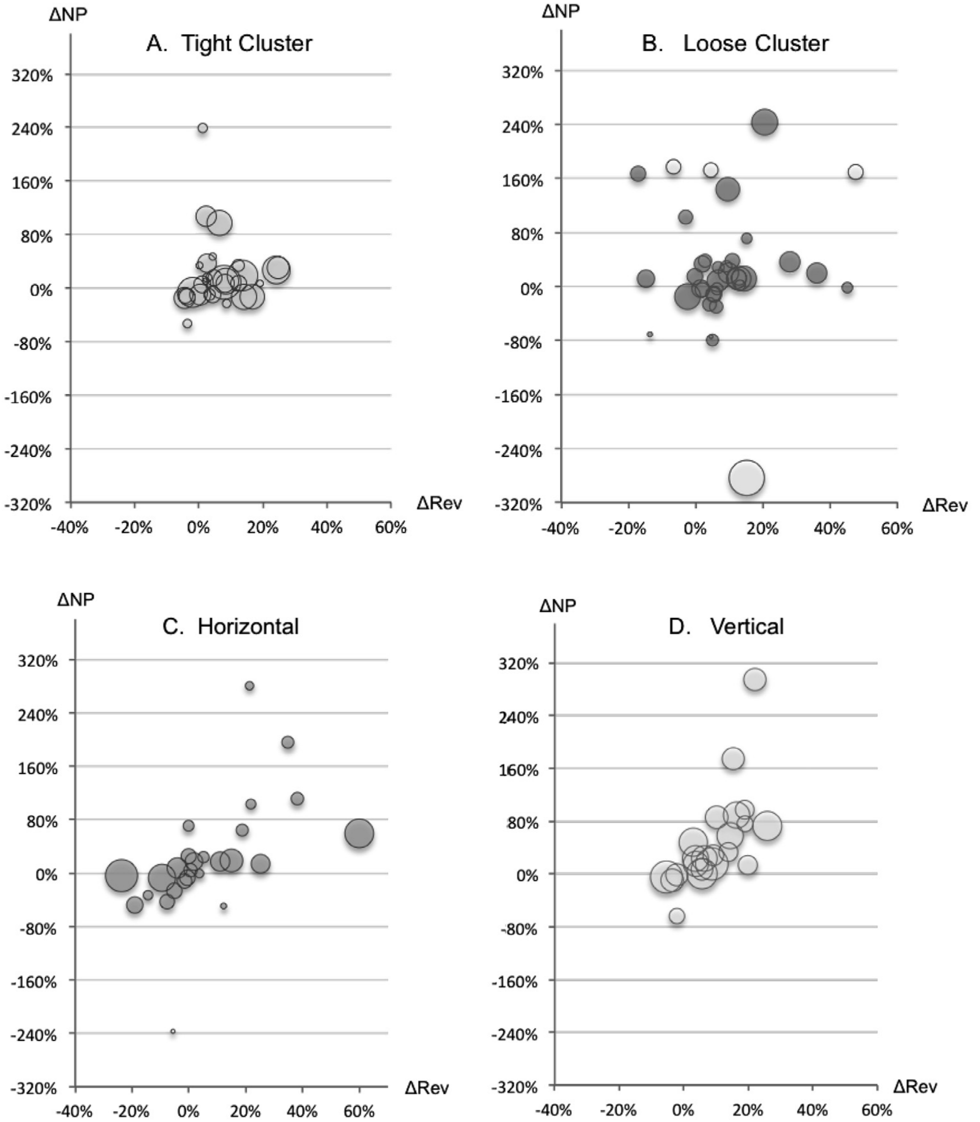

Figure 1.11 PF™ Dispersion Patterns

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industry have different revenue growth fortunes, their profit growths are quite similar but their net profit margins can differ quite a bit. A horizontal cluster can imply that the industry is experiencing some stagnation, as there is almost a zero-sum outcome where market shares are lost and gained, rather than an expansion. In the value-chain, such industries tend to be of the supporting category and further from the consumer. From a market perspective, countries that exhibit this dispersion would have a fair number of industries that are in the supporting or upstream (raw materials) category, e.g. Indonesia, Spain.

D. Vertical Cluster. The vertical (line) plot is also a variation of the tight and loose dispersions observed. The vertical dispersion indicates the companies are able to make different profit levels despite being in the same industry. Depending on the vertical spread and the central cluster, it illustrates that there is probably a lot of differentiation being employed in the industry, e.g. branding, use of technology to improve productivity and reduce costs. These industries tend to be more downstream and closer to the customer, such as restaurants, computer services, airlines, etc. From a market perspective, it indicates markets where the industries are not highly correlated, as it is in industries that are more global than local. We are likely to see more of such dispersion patterns as globalization, technological advancements, demographic and financial shifts, make industries more global.

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Figure 1.12 shows the three common dispersions you can expect from an ACAM™ chart. The spread will differ with each industry and will change every year. What is important is the industry median compared to the sector median. Typically, when more of the companies are in the quadrant where the companies' ability and capability are below the median, the industry is highly competitive with low barrier to entry, especially when it relates to the incumbents' ability to keep new entrants out. At the other end, where the companies' ability and capability exceed that of the sector, the strength of the incumbents is great and it will be difficult to break into this industry.

Figure 1.13 gives the corresponding PF™ plot for the three ACAM™ industry plots. We can see that the industry on the left is highly competitive and the PF™ dispersion illustrates the individual companies' efforts to differentiate themselves. The one in the middle does not see much differentiated activities as the return on investment is somewhat stable. The industry illustrated at the right is typical of a supporting industry and where the horizontal dispersion indicates a maturity, as well as limited growth for the industry as a whole.

At the market level, the ACAM™ plots are useful as they show the spread of all the companies in the various sectors and industries in one chart. By dissecting the plot according to different quartiles — e.g. 90th, 75th and 50th — we can identify companies that are "best-in-class" (there is usually a spread of companies from different industries) and those with the pontential to be.

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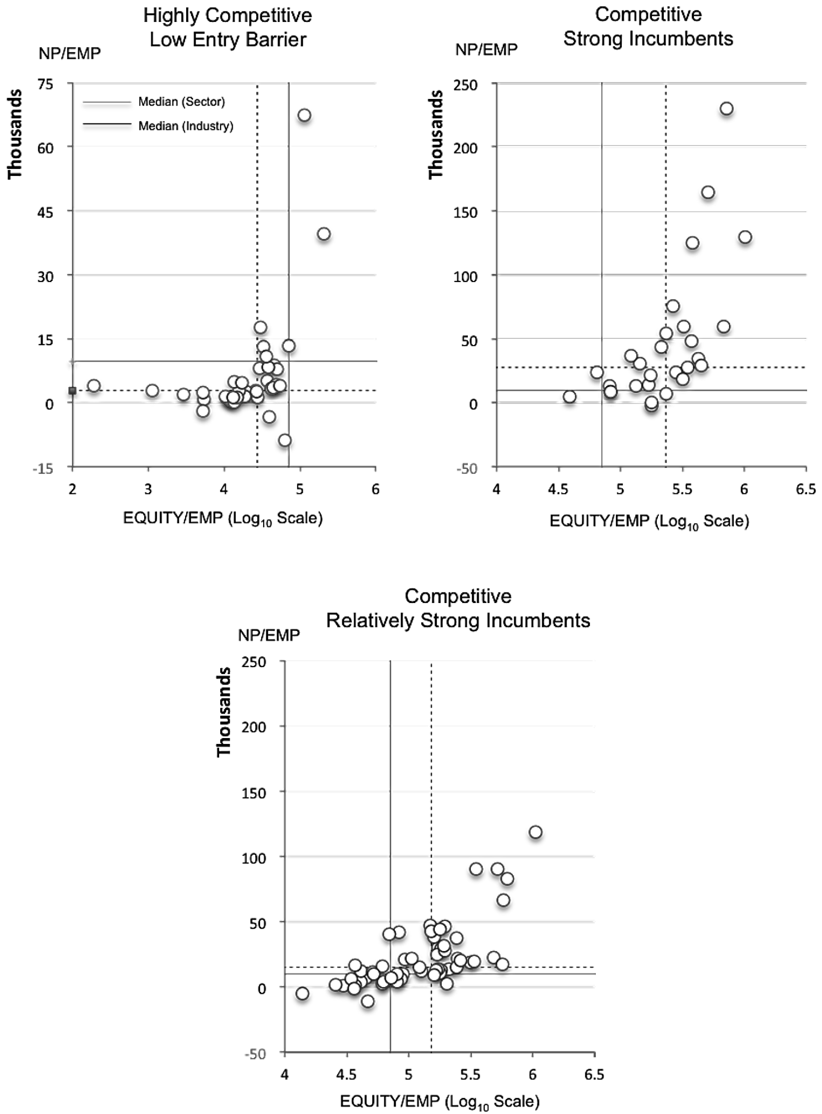

Figure 1.12 ACAM™ Dispersion Patterns

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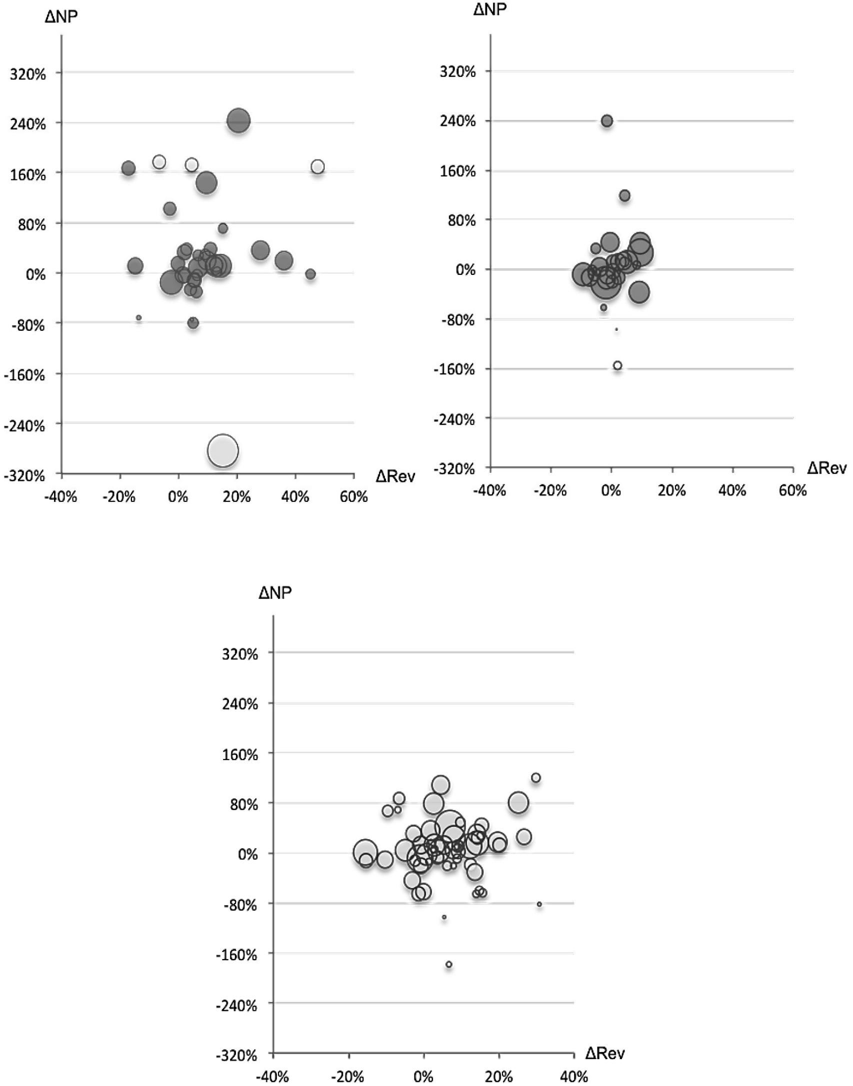

Figure 1.13 PF™ Dispersion Patterns (for above industries)

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You will be able to see the dispersion patterns for the different countries, sectors and industries in Chapters 3, 4 and 5.

Conclusion

The approach used in this book has been developed to provide a perspective on how to value companies, industries, sectors and markets from the ground up. Using fundamental data about companies and how they have performed, we are able to put together a picture that allows us to assess key decision points with regard to our business and help us in our investment decisions.