

Consolidated Statements of Income for Macy's, Inc., 2015–2016
 (in millions, except per share amounts)

	2016	2015
Net sales	\$25,778	\$27,079
Cost of sales	(15,621)	(16,496)
Gross margin	10,157	10,583
Selling, general and administrative expenses	(8,265)	(8,256)
Impairments, store closing and other costs	(479)	(288)
Settlement charges	(98)	—
Operating income	1,315	2,039
Interest expense	(367)	(363)
Premium on early retirement of debt	—	—
Interest income	4	2
Income before income taxes	952	1,678
Federal, state, and local income tax expense	(341)	(608)
Net income	611	1,070
Net loss attributable to noncontrolling interest	8	2
Net income attributable to Macy's, Inc., shareholders	619	1,072
Basic earnings per share attributable to Macy's, Inc., shareholders	\$ 2.01	\$ 3.26
Diluted earnings per share attributable to Macy's, Inc., shareholders	\$ 1.99	\$ 3.22

Consolidated Balance Sheets for Macy's, Inc., 2015–2016 (in millions)

	2016	2015
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 1,297	\$ 1,109
Receivables	522	558
Merchandise inventories	5,399	5,506
Prepaid expenses and other current assets	408	479
Total Current Assets	7,626	7,652
Property and Equipment – net	7,017	7,616
Goodwill	3,897	3,897
Other Intangible Assets – net	498	514
Other Assets	813	897
Total Assets	\$19,851	\$20,576
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Short-term debt	\$309	\$642
Merchandise accounts payable	1,423	1,526
Accounts payable and accrued liabilities	3,563	3,333
Income taxes	352	227
Total Current Liabilities	5,647	5,728
Long-Term Debt	6,562	6,995
Deferred Income Taxes	1,443	1,477
Other Liabilities	1,877	2,123

	2016	2015
Shareholders' Equity:		
Common stock (304.1 and 310.3 shares outstanding)	3	3
Additional paid-in capital	617	621
Accumulated equity	6,088	6,334
Treasury stock	(1,489)	(1,665)
Accumulated other comprehensive loss	(896)	(1,043)
Total Macy's, Inc., Shareholders' Equity	4,323	4,250
Noncontrolling interest	(1)	3
Total Shareholders' Equity	4,322	4,253
Total Liabilities and Shareholders' Equity	\$19,851	\$20,576

Source: Macy's, Inc., 2016 10-K.

2. REI operates more than 140 sporting goods and outdoor recreation stores in 36 states. How many of the four tests of the competitive power of a resource does the retail store network pass? Explain your answer. **LO4-2**
3. Review the information in Concepts & Connections 4.1 concerning Boll & Branch's average costs of producing and selling a king-sized sheet set, and compare this with the representative value chain depicted in Figure 4.1. Then answer the following questions: **LO4-3**
 - a. Which of the company's costs correspond to the primary value chain activities depicted in Figure 4.1?
 - b. Which of the company's costs correspond to the support activities described in Figure 4.1?
 - c. What value chain activities might be important in securing or maintaining Boll & Branch's competitive advantage? Explain your answer.
4. Using the methodology illustrated in Table 4.3 and your knowledge as an automobile owner, prepare a competitive strength assessment for General Motors and its rivals Ford, Chrysler, Toyota, and Honda. Each of the five automobile manufacturers should be evaluated on the key success factors/strength measures of cost competitiveness, product-line breadth, product quality and reliability, financial resources and profitability, and customer service. What does your competitive strength assessment disclose about the overall competitiveness of each automobile manufacturer? What factors account most for Toyota's competitive success? Does Toyota have competitive weaknesses that were disclosed by your analysis? Explain. **LO4-4**

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LO4-4



EXERCISES FOR SIMULATION PARTICIPANTS

1. Using the formulas in the Appendix and the data in your company's latest financial statements, calculate the following measures of financial performance for your company: **LO4-1**
 1. Operating profit margin
 2. Return on total assets
 3. Current ratio
 4. Working capital
 5. Long-term debt-to-capital ratio
 6. Price-earnings ratio

APPENDIX

Key Financial Ratios: How to Calculate Them and What They Mean

Ratio	How Calculated	What It Shows
Profitability Ratios		
1. Gross profit margin	$\frac{\text{Sales revenues} - \text{Cost of goods sold}}{\text{Sales revenues}}$	Shows the percentage of revenues available to cover operating expenses and yield a profit. Higher is better, and the trend should be upward.
2. Operating profit margin (or return on sales)	$\frac{\text{Sales revenues} - \text{Operating expenses}}{\text{Sales revenues}}$ or $\frac{\text{Operating income}}{\text{Sales revenues}}$	Shows the profitability of current operations without regard to interest charges and income taxes. Higher is better, and the trend should be upward.
3. Net profit margin (or net return on sales)	$\frac{\text{Profits after taxes}}{\text{Sales revenues}}$	Shows after-tax profits per dollar of sales. Higher is better, and the trend should be upward.
4. Total return on assets	$\frac{\text{Profits after taxes} + \text{Interest}}{\text{Total assets}}$	A measure of the return on total monetary investment in the enterprise. Interest is added to after-tax profits to form the numerator since total assets are financed by creditors as well as by stockholders. Higher is better, and the trend should be upward.
5. Net return on total assets (ROA)	$\frac{\text{Profits after taxes}}{\text{Total assets}}$	A measure of the return earned by stockholders on the firm's total assets. Higher is better, and the trend should be upward.
6. Return on stockholders' equity	$\frac{\text{Profits after taxes}}{\text{Total stockholders' equity}}$	Shows the return stockholders are earning on their capital investment in the enterprise. A return in the 12–15% range is "average," and the trend should be upward.
7. Return on invested capital (ROIC) – sometimes referred to as return on capital (ROCE)	$\frac{\text{Profits after taxes}}{\text{Long-term debt} + \text{Total stockholders' equity}}$	A measure of the return shareholders are earning on the long-term monetary capital invested in the enterprise. Higher is better, and the trend should be upward.
8. Earnings per share (EPS)	$\frac{\text{Profits after taxes}}{\text{Number of shares of common stock outstanding}}$	Shows the earnings for each share of common stock outstanding. The trend should be upward, and the bigger the annual percentage gains, the better.
Liquidity Ratios		
1. Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Shows a firm's ability to pay current liabilities using assets that can be converted to cash in the near term. Ratio should definitely be higher than 1.0; ratios of 2 or higher are better still.
2. Working capital	$\text{Current assets} - \text{Current liabilities}$	Bigger amounts are better because the company has more internal funds available to (1) pay its current liabilities on a timely basis and (2) finance inventory expansion, additional accounts receivable, and a larger base of operations without resorting to borrowing or raising more equity capital.
Leverage Ratios		
1. Total debt-to-assets ratio	$\frac{\text{Total debt}}{\text{Total assets}}$	Measures the extent to which borrowed funds (both short-term loans and long-term debt) have been used to finance the firm's operations. A low fraction or ratio is better—a high fraction indicates overuse of debt and greater risk of bankruptcy.

Ratio	How Calculated	What It Shows
2. Long-term debt-to-capital ratio	$\frac{\text{Long-term debt}}{\text{Long-term debt} + \text{Total stockholders' equity}}$	An important measure of creditworthiness and balance sheet strength. It indicates the percentage of capital investment in the enterprise that has been financed by both long-term lenders and stockholders. A ratio below 0.25 is usually preferable since monies invested by stockholders account for 75% or more of the company's total capital. The lower the ratio, the greater the capacity to borrow additional funds. Debt-to-capital ratios above 0.50 and certainly above 0.75 indicate a heavy and perhaps excessive reliance on long-term borrowing, lower creditworthiness, and weak balance sheet strength.
3. Debt-to-equity ratio	$\frac{\text{Total debt}}{\text{Total stockholders' equity}}$	Shows the balance between debt (funds borrowed both short-term and long-term) and the amount that stockholders have invested in the enterprise. The farther the ratio is below 1.0, the greater the firm's ability to borrow additional funds. Ratios above 1.0 and definitely above 2.0 put creditors at greater risk, signal weaker balance sheet strength, and often result in lower credit ratings.
4. Long-term debt-to-equity ratio	$\frac{\text{Long-term debt}}{\text{Total stockholders' equity}}$	Shows the balance between long-term debt and stockholders' equity in the firm's long-term capital structure. Low ratios indicate greater capacity to borrow additional funds if needed.
5. Times-interest-earned (or coverage) ratio	$\frac{\text{Operating income}}{\text{Interest expenses}}$	Measures the ability to pay annual interest charges. Lenders usually insist on a minimum ratio of 2.0, but ratios progressively above 3.0 signal progressively better creditworthiness.
Activity Ratios		
1. Days of inventory	$\frac{\text{Inventory}}{\text{Cost of goods sold} \div 365}$	Measures inventory management efficiency. Fewer days of inventory are usually better.
2. Inventory turnover	$\frac{\text{Cost of goods sold}}{\text{Inventory}}$	Measures the number of inventory turns per year. Higher is better.
3. Average collection period	$\frac{\text{Accounts receivable}}{\text{Total sales} \div 365}$ or $\frac{\text{Accounts receivable}}{\text{Average daily sales}}$	Indicates the average length of time the firm must wait after making a sale to receive cash payment. A shorter collection time is better.
Other Important Measures of Financial Performance		
1. Dividend yield on common stock	$\frac{\text{Annual dividends per share}}{\text{Current market price per share}}$	A measure of the return that shareholders receive in the form of dividends. A "typical" dividend yield is 2–3%. The dividend yield for fast-growth companies is often below 1% (maybe even 0); the dividend yield for slow-growth companies can run 4–5%.
2. Price-earnings ratio	$\frac{\text{Current market price per share}}{\text{Earnings per share}}$	P-E ratios above 20 indicate strong investor confidence in a firm's outlook and earnings growth; firms whose future earnings are at risk or likely to grow slowly typically have ratios below 12.
3. Dividend payout ratio	$\frac{\text{Annual dividends per share}}{\text{Earnings per share}}$	Indicates the percentage of after-tax profits paid out as dividends.
4. Internal cash flow	After tax profits + Depreciation	A quick and rough estimate of the cash a company's business is generating after payment of operating expenses, interest, and taxes. Such amounts can be used for dividend payments or funding capital expenditures.
5. Free cash flow	After tax profits + Depreciation – Capital expenditures – Dividends	A quick and rough estimate of the cash a company's business is generating after payment of operating expenses, interest, taxes, dividends, and desirable reinvestments in the business. The larger a company's free cash flow, the greater is its ability to internally fund new strategic initiatives, repay debt, make new acquisitions, repurchase shares of stock, or increase dividend payments.