

# THE SIMPLER THE CORPORATE STRATEGY, THE BETTER THE FINANCIAL RESULTS

A comparative study of the transformation  
of corporate strategy into financial results:  
Amazon.com and LAOX Ltd

MIYAMASU, Hiroshi

## ABSTRACT

This paper explores the transformation of corporate strategy into financial results, and by doing so, it does not fall into a single academic category of Accounting, Management or Economics. This study is important and valuable because making a great strategy does not guarantee a great result. The strategy might be misunderstood or disregarded and tends to incur dilution rather than coagulation during the transformation process.

The challenges of such a study are the broad scope (i.e., to cover all the activities of a corporation) and the limited access to the internal information of a corporation (e.g., strategy, budget). But the study becomes possible if the scope is narrowed, a certain definition is adapted, and some presumptions are used.

This paper examines the cases of two publicly traded retail corporations in the United States and Japan, contrasting their strategies and financial results. The implications drawn were:

- The simpler or less abstract a corporate strategy is, the better or more predictable the financial results are.
- If structural level issues are dealt with at a higher level of the management process (i.e., strategic planning rather than operational planning, operational planning rather than implementation), the likelihood of the above transformation will be increased.

## INTRODUCTION

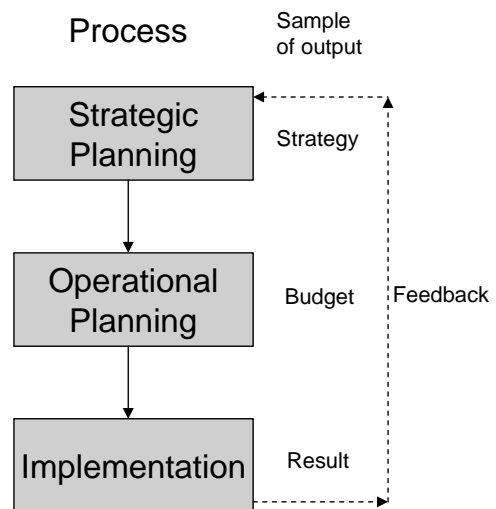
To be successful in business, the importance of strategy goes without question. But at the same time, there should be no other time than now to require a simple strategy. Many corporations use the management process depicted in Figure 1. First, for strategic planning, they analyze industries, define positions, measure shares, draw a chart of strengths/weaknesses/opportunities/threats, and make a strategy. Second, for operational planning, they consider more short-term, specific, tangible actionable plans and draw up a budget. They then might implement and the results are analyzed and fed back to the beginning of the whole process. In other words, strategy, as an output of strategic planning, is transformed into a budget. A budget, as an outcome of operational planning, is transformed into a result. A result, as an outcome of implementation, is fed back to the beginning of the whole process.

The study of those transformations as an aggregate, rather than as separate processes, is very important and valuable. Having a great strategic planning process and making a great strategy do not guarantee a great result. Generally a dilution, rather than a coagulation, occurs during the process, especially at a large-sized corporation. If the strategy is complex, misunderstandings tend to occur. If unrealistic, credibility will be lost, leading to unplanned or undesired results.

The instinct of this paper's author, with two decades in practice, is that the simpler the strategy, the better the result. "Simpler" here means being non-superficial, realistic and clear about what to give up. "Better" here, means doing almost as planned, generating less surprise, and being consistent, honest and loyal to stakeholders.

However, pursuing such a study poses a few challenges. One is that observation of the overall processes is too broad or impractical because those processes are the corporation's entire activities. Another is the question of how to define the result. It could be related to financial results, market position, customer satisfaction or even environmental conditions. Yet a further challenge is how to access and obtain the relevant information and data of a certain corporation. Most companies do not disclose their strategy, budget or result. The author of this paper does not have any intention to refer to any confidential, internal information of his previous employers. But by narrowing the scope as follows, the study becomes possible.

**Figure 1:**  
**Common Management Process**



- Focusing just on the starting point of output (i.e., the strategy) and the ending point (i.e., the result)
- Focusing on financial results
- Using the information and data of a publicly traded corporation

A publicly traded corporation has to disclose its financial results regularly. It occasionally discloses its strategy, such as when its financial condition is difficult or some future financial arrangements are necessary. In such cases, a corporation needs to disclose and explain its strategy to investors, creditors or other external stakeholders and obtain their consensus.

This paper explores the transformation of strategy into financial results by Amazon.com in the United States and by LAOX Ltd. in Japan. Both are publically traded retail corporations. Retail corporations were chosen because their value chain structures are simpler (i.e., without, or with less, research & development and manufacturing function) than the norm, and show a more direct transformation of strategy into financial results. Amazon.com and Laox Ltd. were chosen for the purpose of contrasting their financial results. The financial results of Amazon.com have been significantly improving, while those of Laox Ltd. have been falling free.

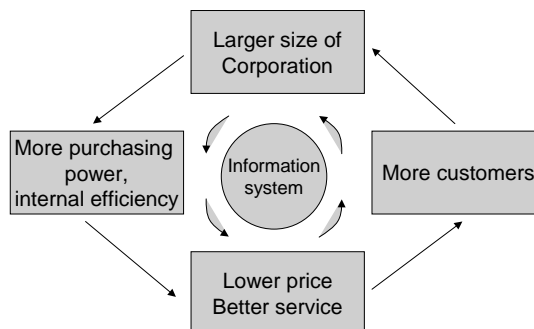
This paper is organized into three sections. Section I explores the transformation of strategy into financial results by Amazon.com. Section II explores that of Laox Ltd. Section III develops implications. The author is aware that a conclusion cannot be drawn from the study of just two companies, but he believes that this paper adds some value to the management process study and wishes to contribute to opening the door between strategy and management accounting.

## SECTION I – THE CASE OF AMAZON.COM

**Common Phenomena of the Retail Industry:** In the retail industry, there is a golden rule that states “the bigger, the better.” Generally, as the size of a corporation becomes bigger, it obtains more purchase power and more internal efficiency. It negotiates more toughly with suppliers and vendors and purchases goods at a lower cost. It may introduce a powerful and efficient infrastructure and share it across the entire organization of the corporation. As a result, it can offer lower prices and attract more customers. This cycle continues, creating a good spiral, as shown in Figure 2.

In the last decade, the speed of this cycle seems to be accelerating mainly because of the development of the information system. For example, through the Internet, a corporation can monitor many of its competitor's activities, such as pricing, selection, and customer convenience, in a timely fashion and adapt quickly. Customers do the same and rush to corporations that offer the best value. The speed of the cycle therefore becomes naturally faster. In the

Figure 2:  
Retail Corporation Growth Cycle



the last few years, the appearance of social networks and smart phone devices has accelerated the speed further, by enabling corporations and customers to access relevant information more efficiently and more frequently. However, in the course of this cycle, it is common for a start-up corporation to (1) face financial difficulties and (2) be pushed out of the market. While it still does not have much purchasing power or internal efficiency, it has to price low enough to attract customers, unless it has a significant differentiation from its competitors. In the case of Amazon.com (AMZN), (1) was applied but not (2). To understand why, we need to examine AMZN's financial difficulties first, their financial arrangements second, and their transformation of strategy into financial results finally.

**Financial Difficulties:** Table 1 shows AMZN's operating loss for seven years from 1995 to 2001. During this period, the gross margin was between 17.7% and 25.6%, while the expenses per revenue were between 38.7% and 79.5%, resulting in operating loss. But after 2002, the gross margin has constantly been above 22.3%, while the expenses per revenue have been decreasing to below 20%, resulting in operating profit. The expenses can be broken down further into Fulfillment, Marketing, Technology and content, General and administrative, Stock-based compensation<sup>1</sup>, and Other expenses. Decrease in those expenses per revenue can be seen in all of those categories during the period from 1995 to 2010. This can be viewed as an improvement of internal efficiency, as shown in Figure 2. Additionally, other expenses significantly increased from 1998 to 2001 owing to the amortization of goodwill from purchased corporations. The reason for the constant, not significantly improving, gross margin may be due to the addition of product categories. In 1994, AMZN started with one product category of Books, but by 2010 they had dozens of product categories. Generally the gross margin of a newly added category is low, for the same reason as mentioned in the previous paragraph, even though that of the existing category is improving. If so, the overall gross margin can be consistent.

<sup>1</sup> Table 1 does not reflect the reclassification of stock-based compensation from 1998 to 2004.

Table 1: AMZN Selected Income Statements

(Millions of USD)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Revenues</b>	<b>\$1</b>	<b>\$16</b>	<b>\$148</b>	<b>\$610</b>	<b>\$1,640</b>	<b>\$2,761</b>	<b>\$3,122</b>	<b>\$3,932</b>	<b>\$5,263</b>	<b>\$6,921</b>	<b>\$8,490</b>	<b>\$10,711</b>	<b>\$14,835</b>	<b>\$19,166</b>	<b>\$24,509</b>	<b>\$34,204</b>
Cost of goods sold	0	12	119	476	1,349	2,106	2,323	2,940	4,006	5,319	6,451	8,255	11,482	14,896	18,978	26,561
<b>Gross Margin</b>	<b>0</b>	<b>3</b>	<b>29</b>	<b>134</b>	<b>291</b>	<b>655</b>	<b>799</b>	<b>992</b>	<b>1,257</b>	<b>1,601</b>	<b>2,039</b>	<b>2,456</b>	<b>3,353</b>	<b>4,270</b>	<b>5,531</b>	<b>7,643</b>
Fulfillment						414	374	392	477	590	745	937	1,292	1,658	2,052	2,898
Marketing	0	6	39	133	413	179	138	125	122	158	198	263	344	482	660	1,029
Technology and content	0	2	12	46	160	269	241	215	207	251	451	662	818	1,033	1,240	1,734
General and administrative	0	1	7	16	70	108	89	79	88	112	166	195	235	279	328	470
Stock-based compensation				2	31	24	4	68	88	57						
Other expenses				46	223	521	362	47	3	(8)	47	10	9	(24)	102	106
Total expenses	0	9	58	243	896	1,515	1,208	926	985	1,160	1,607	2,067	2,698	3,428	4,402	6,237
<b>Operating profit (loss)</b>	<b>(\$0)</b>	<b>(\$6)</b>	<b>(\$29)</b>	<b>(\$109)</b>	<b>(\$606)</b>	<b>(\$860)</b>	<b>(\$409)</b>	<b>\$66</b>	<b>\$272</b>	<b>\$441</b>	<b>\$432</b>	<b>\$389</b>	<b>\$655</b>	<b>\$842</b>	<b>\$1,129</b>	<b>\$1,406</b>
Percentage of Revenue																
<b>Revenues</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>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of goods sold	80.0%	78.0%	80.5%	78.1%	82.3%	76.3%	74.4%	74.8%	76.1%	76.9%	76.0%	77.1%	77.4%	77.7%	77.4%	77.7%
<b>Gross Margin</b>	<b>20.0%</b>	<b>22.0%</b>	<b>19.5%</b>	<b>21.9%</b>	<b>17.7%</b>	<b>23.7%</b>	<b>25.6%</b>	<b>25.2%</b>	<b>23.9%</b>	<b>23.1%</b>	<b>24.0%</b>	<b>22.9%</b>	<b>22.6%</b>	<b>22.3%</b>	<b>22.6%</b>	<b>22.3%</b>
Fulfillment	0.0%	0.0%	0.0%	0.0%	0.0%	15.0%	12.0%	10.0%	9.1%	8.5%	8.8%	8.7%	8.7%	8.7%	8.4%	8.5%
Marketing	39.1%	38.7%	26.4%	21.7%	25.2%	6.5%	4.4%	3.2%	2.3%	2.3%	2.3%	2.5%	2.3%	2.5%	2.8%	3.0%
Technology and content	33.5%	14.7%	8.4%	7.6%	9.7%	9.7%	7.7%	5.5%	3.9%	3.6%	5.3%	6.2%	5.5%	5.4%	5.1%	5.1%
General and administrative	6.8%	6.6%	4.4%	2.6%	4.3%	3.9%	2.9%	2.0%	1.7%	1.6%	2.0%	1.8%	1.6%	1.5%	1.3%	1.4%
Stock-based compensation	0.0%	0.0%	0.0%	0.3%	1.9%	0.9%	0.1%	1.7%	1.0%	0.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other expenses	0.0%	0.0%	0.0%	7.6%	13.6%	18.9%	11.6%	1.2%	0.1%	-0.1%	0.6%	0.1%	0.1%	-0.1%	0.4%	0.3%
Total expenses	79.5%	59.9%	39.3%	39.8%	54.7%	54.9%	38.7%	23.6%	18.7%	16.8%	18.9%	19.3%	18.2%	17.9%	18.0%	18.2%
<b>Operating profit (loss)</b>	<b>-59.5%</b>	<b>-38.0%</b>	<b>-19.8%</b>	<b>-17.9%</b>	<b>-36.9%</b>	<b>-31.1%</b>	<b>-13.1%</b>	<b>1.7%</b>	<b>5.2%</b>	<b>6.4%</b>	<b>5.1%</b>	<b>3.6%</b>	<b>4.4%</b>	<b>4.4%</b>	<b>4.6%</b>	<b>4.1%</b>

**Financial Arrangements:** The question arises here of how AMZN survived despite recognizing operating losses for seven years since its inception. What kind of financial arrangements were made, if any? Many companies would go bankrupt in such a condition. From here, the focus will shift from AMZN's Income Statements to their Balance Sheets and Statements of Cash Flows.

Three financial arrangements can be found in Table 2. One is the increase of long-term liabilities in 1999, mainly owing to the issuance of 4.75% convertible subordinated notes for \$1,250 million. The second financial arrangement is also the increase of long-term liabilities in 2000, mainly owing to the issuance of 6.875% PEACS for €690 million (equivalent to \$714 million at the exchange rate of 1.035). Both were due 10 years after the issuance and offered attractive future conversion prices. The third financial arrangement is the constant increase of additional paid-in capital from 1997 to 2000, mainly owing to the initial public offering in 1997 and to the acquisitions of corporations (e.g., Exchange.com, LiveBid, Accept.com, Alexa.com, Tool Crib) through the issuance of stocks, not cash.

Table 2: AMZN Condensed Balance Sheets

(Millions of USD)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Cash and equivalent	\$6	\$2	\$26	\$133	\$822	\$540	\$738	\$1,102	\$1,303	\$1,013	\$1,022	\$2,539	\$2,769	\$3,444	\$3,777
Other current assets	1	135	398	879	539	668	878	719	1,236	1,916	2,351	2,625	3,388	6,353	9,970
Current assets	7	137	424	1,012	1,361	1,208	1,616	1,821	2,539	2,929	3,373	5,164	6,157	9,797	13,747
Long-term assets	1	12	224	1,460	774	430	374	341	710	767	990	1,321	2,157	4,016	5,050
<b>Total assets</b>	<b>8</b>	<b>149</b>	<b>648</b>	<b>2,472</b>	<b>2,135</b>	<b>1,638</b>	<b>1,990</b>	<b>2,162</b>	<b>3,249</b>	<b>3,696</b>	<b>4,363</b>	<b>6,485</b>	<b>8,314</b>	<b>13,813</b>	<b>18,797</b>
Current liabilities	5	44	162	739	974	921	1,066	1,252	1,620	1,899	2,532	3,714	4,746	7,364	10,372
Long-term liabilities	77	348	1,466	2,127	2,156	2,277	1,945	1,855	1,551	1,400	1,574	896	1,192	1,561	1,561
Common stock	0	0	3	3	4	4	4	4	4	4	4	4	4	5	5
Additional paid-in capital	10	64	299	1,198	1,338	1,463	1,649	1,899	2,124	2,263	2,517	2,563	3,521	5,136	5,725
Others	(1)	(2)	(1)	(51)	(16)	(46)	3	35	30	6	(253)	5	(123)	(56)	(190)
Retained earnings (losses)	(6)	(34)	(162)	(882)	(2,292)	(2,860)	(3,009)	(2,973)	(2,384)	(2,027)	(1,837)	(1,375)	(730)	172	1,324
<b>Total liabilities and stockholders' equity</b>	<b>\$8</b>	<b>\$149</b>	<b>\$648</b>	<b>\$2,472</b>	<b>\$2,135</b>	<b>\$1,638</b>	<b>\$1,990</b>	<b>\$2,162</b>	<b>\$3,249</b>	<b>\$3,696</b>	<b>\$4,363</b>	<b>\$6,485</b>	<b>\$8,314</b>	<b>\$13,813</b>	<b>\$18,797</b>
Notes															
Current assets less current liabilities	\$2	\$93	\$263	\$273	\$387	\$287	\$550	\$569	\$919	\$1,030	\$841	\$1,450	\$1,411	\$2,433	\$3,375

A constant cash flow improvement can be found in Table 3. The free cash flow (i.e., cash inflow from operations less capital expenditure) of AMZN has been always better than the operating profit shown in Table 1, as well as improving earlier than the operating profit. From an early stage, AMZN emphasized long-term, sustainable free cash flow growth and

has been improving DPO, DSO, inventory, and so forth. In addition, AMZN changed the order of financial statements in their annual reports from the year ending in December 31, 2003. Previously, they presented financial statements in the order of Balance Sheet, Income Statement, Statement of Cash Flows and Stockholders' Equity. Since 2003, they present the financial statements in the order of Statement of Cash Flows, Income Statement, Balance Sheet and Stockholders' Equity. AMZN is unique in using this order (i.e., placing the Statement of Cash Flows at the beginning). This can be another signal that they emphasize free cash flow.

Table 3: AMZN Selected Statements of Cash Flows

(Millions of USD)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Cash flows from operating activities	(\$0)	(\$2)	\$4	\$31	(\$91)	(\$130)	(\$120)	\$174	\$392	\$566	\$733	\$702	\$1,405	\$1,697	\$3,293	\$3,495
Investment to purchase of PP&E	(0)	(1)	(7)	(28)	(287)	(135)	(50)	(39)	(46)	(89)	(204)	(216)	(224)	(333)	(373)	(979)
<b>Free Cash Flow</b>	<b>(\$0)</b>	<b>(\$3)</b>	<b>(\$4)</b>	<b>\$3</b>	<b>(\$378)</b>	<b>(\$265)</b>	<b>(\$170)</b>	<b>\$135</b>	<b>\$346</b>	<b>\$477</b>	<b>\$529</b>	<b>\$486</b>	<b>\$1,181</b>	<b>\$1,364</b>	<b>\$2,920</b>	<b>\$2,516</b>

Thus, AMZN maintained a healthy cash level, even during a financially difficult period, kept growing, and finally established a strong position in the retail market: Its current assets have been always exceeding its current liabilities since its inception as shown in Table 2. Undoubtedly, good financial arrangements were made.

**Strategy's Effect on Financial Arrangements:** Then, the next question arises as to how such arrangements were made. Was it done by chance or planned much in advance? To be more specific, which management process, shown in Figure 1, triggered those financial arrangements? Was it strategic planning, operational planning, implementation, or a combination of those? Other than by interviewing AMZN executives at the time, there is no way to reach the answer of this question. Search Engines do not provide the answer either. But AMZN's public disclosure during the financially difficult period should provide some hints. As mentioned earlier, a publicly traded corporation occasionally needs to explain its strategy to investors, creditors or other external stakeholders and to obtain their consensus. Some hints were found in the letters to shareholders from 1997 to 2000. The following are quotes from those:

- The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital (1997).
- Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas (1997).
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions (1997).

- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows (1997).
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business. We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take (1997).
- In our 1997 letter to shareholders (our first), we detailed our long-term investment approach. Because we continue to add many new shareholders, we've appended that letter immediately after this year's. I invite you to please read the section entitled It's All About the Long Term, as it is the best way I know to help make sure we're the kind of corporation you want to be invested in. As we wrote there, we don't claim it's the right philosophy, we just claim it's ours (1998).
- As I usually do, I've appended our 1997 letter, our first letter to shareholders. It gets more interesting every year that goes by, in part because so little has changed. I especially draw your attention to the section entitled "It's All About the Long Term" (1999, 2000).

Repeatedly, (i) the establishment of long-term market leadership and (ii) the prioritization of growth and long-term cash flow rather than short-term profitability were emphasized. AMZN discloses their vision in their investor relationship website<sup>2</sup> to be earth's most customer-centric company and to build a place where people can come to find and discover anything they might want to buy online. But they do not mention their long-term goal or strategy. But (i) can be presumed as their long-term goal and (ii) as their strategy. Although there are many definitions of strategy, one of the well-known definitions is "Strategy is the basic goals and objectives of the organization, the major programs of action chosen to reach these goals and objectives, and the major pattern of resource allocation used to relate the organization to its environment."<sup>3</sup> In AMZN's case, (ii) is the major programs of actions to reach (i), and the major pattern of resource allocation, in agreement with the definition. Thus, the presumption made here can be assumed to be fairly accurate.

Under the above presumption, the beauty of AMZN's strategy is:

- High consistency with the long-term goal

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<sup>2</sup> <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-faq>

<sup>3</sup> Schendel and Hatten (1972)

- Prediction in advance of the short-term profitability issue, but still, clear prioritization of growth and long-term cash flow rather than the short-term profitability
- Openness and honesty in its disclosure of the above to the public

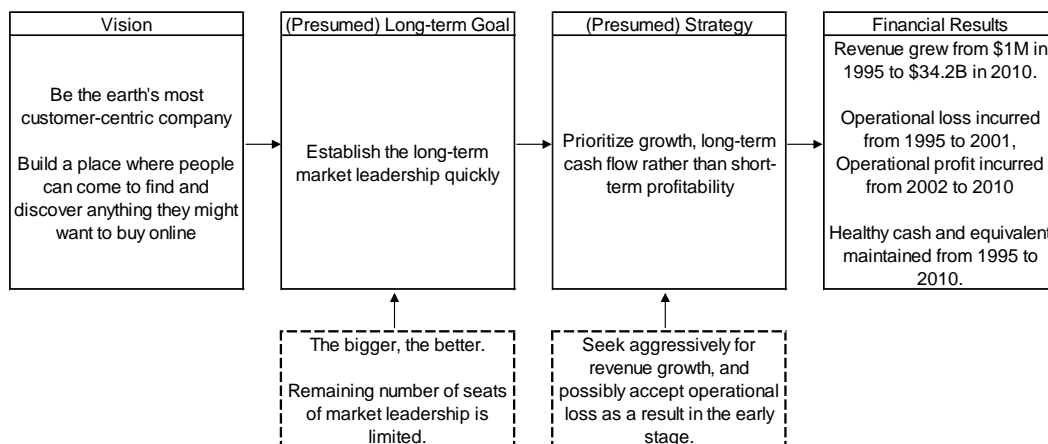
Generally, it is easy for a publicly traded corporation to announce positive matters but difficult to announce negative matters (e.g., lower prioritization of short-term profitability). But since its inception, AMZN did not refrain from announcing negative information. Their clear, consistent and honest strategy must have avoided a lot of confusion (e.g., which to emphasize, revenue or profit?) among internal and external stakeholders, gained those people's trust, especially from investors for convertible subordinated notes issued in 1999 and 2000, and contributed to overcoming the financial difficulties.

**Transformation of a strategy into financial results:** AMZN's vision, to be earth's most customer-centric company and to build a place where people can come and find and discover anything they might want to buy online, became more tangible and was transformed into their goal of moving quickly and establishing the long-term market leadership. Behind the transformation, there might be ideas that the bigger, the better, or that the remaining number of seats for market leadership is limited. Their strategy clearly indicated prioritization of growth and long-term cash flow rather than short-term profitability to reach to their long-term goal and was transformed into their financial results, almost exactly as planned. AMZN's revenue grew 34 thousand times from 1995 to 2010. Operating loss was incurred from 1995 to 2001, but operating profit has been in place from 2002 to 2010. Healthy cash and equivalent have been maintained from 1995 to 2010. Behind the transformation, there might be the idea that aggressively seeking revenue growth requires accepting operating loss at the early stage. Figure 3 summarizes those transformations.

Despite some uncertainty of the presumption made here, AMZN's case can still be concluded as a successful transformation of strategy to financial results.



Figure 3: Transformation of Vision, Long-term Goal, Strategy and Financial Results

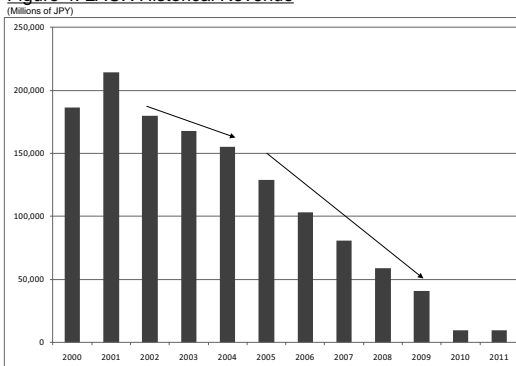


## SECTION II – THE CASE OF LAOX LTD

**Laox Ltd and their Environment:** Laox Ltd (LAOX) is a publicly traded corporation in Japan that focuses on consumer electronics and home appliances (CE&HA) retail business. They were incorporated in 1976 and listed in the second section of the Tokyo Stock Exchange in 1999. They were strong in audio and media segments, and used to be a symbolic CE&HA retail corporation in Japan, having many stores near Akihabara station in Tokyo. But their revenue<sup>4</sup> peaked in 2001 and has been falling down ever since as shown in Figure 4. The major reason for the decrease is the customers lost to road-side or rail-side corporations that run low-cost operations and offer lower prices to customers.

Although LAOX's business is not fully compatible with that of AMZN, it was chosen here for the purpose of contrasting its strategy and financial results with those of AMZN. In the difficult financial conditions mentioned above, LAOX's strategy should have been bolder and clearer than that of AMZN and expected to be transformed into financial results in the shorter term. To examine the case of LAOX, the following paragraphs are organized in the order of Strategy, Financial Results, and Dilemma.

Figure 4: LAOX Historical Revenue



<sup>4</sup> Based on statutory GAAP in Japan, the fiscal year ending March 31

**Strategy:** To find LAOX’s strategy, the same methodology described in the Introduction and Case of AMZN sections, was applied. A publicly traded corporation discloses its strategy occasionally, such as when its financial condition is difficult or some future financial arrangements are necessary. In such cases, the corporation needs to disclose and explain its strategy to investors, creditors or other external stakeholders to obtain their consensus. In the case of LAOX, its revenue decreased sharply from 2005 to 2007 as shown in Figure 4. Some hints are found in their annual report<sup>5</sup> for that period:

- a. Our most important objective is to adapt to the changing environment (2005).
- b. Under the slogan of “adaption to change and strength of basics,” we’ve worked hard to innovate ourselves. Major items, performed in the first half of the fiscal year, were reducing indirect expenses, such as consolidating headquarters floors, reducing logistics costs, including industrial waste disposal, introducing a new information system, including elimination of under-utilized systems, consolidation of information systems, usage of an Internet-based daily morning assembly, and revolution of employee consciousness, such as discontinuation of customer-waiting style and changing price negotiation styles. In the second half, we’ve started an aggressive revolution. Major changes are promotion of focused items, such as selecting such items and lowering their purchase costs and prices, revolution of merchandising, such as adapting to the environment and releasing information to stores; and revolution of floors in stores, such as mass product display, recommendation of usage, and combination of products (2005).
- c. We will accelerate the speed of opening up “resolution-type stores” and introduce new types of customer support programs to obtain new customers, to keep existing customers and to increase revenue (2005).
- d. Our most important objective is to adapt to the changing environment (2006).
- e. We opened ten, closed four, and renewed eight stores (2006).
- f. We will increase our service level by increasing delivery options and customer satisfaction by LAOX master and we will establish different marketing methodologies according to the segment. We will introduce an early retirement program and close unprofitable stores (2006).

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<sup>5</sup> The above quotes written in Japanese were translated into English by the author’s best effort. There might be errors and misinterpretations. For the original, please refer to  
<<http://www.ullet.com/%E3%83%A9%E3%82%AA%E3%83%83%E3%82%AF%E3%82%B9/EDINET#EDINET/page/2/ranking/report>>

- g. Our most important objective is to stop the decrease of revenue and to be profitable (2007).
- h. We closed 18 unprofitable stores (2007).
- i. We will expand the selection of supply, consumables, and kitchen products and promote them (2007).

Using the same definition mentioned previously, statements b, c, e, f, h, and i can be presumed to be LAOX's strategy because those are the major programs of action and resource allocations to reach to the objectives of a, d and g. There might be a disagreement with this presumption, such as "LAOX had a totally different strategy internally and they just did not disclose them externally, considering the competition." In that case, the author considers that that would be a breach of fiduciary duty to stakeholders not to disclose material information in such a difficult environment, and therefore the presumption remains reasonable.

The author's impressions of LAOX's (presumed) strategy compared with AMZN's strategy are:

- More itemized but each refers to a relatively minor financial impact; questionable if objectives could be achieved from those
- No mention of specific actions vis à vis the fundamental issue of competitive pricing

As opposed to the repeated usage of "revolution" in statements a to i, the author could not find any revolutionary strategy, such as discontinuation of certain segments or change in the business structure.

**Financial Results:** Table 4 shows the LAOX selected financials based on the statutory GAAP in Japan (JGAAP) with reclassifications of the loyalty point reserve from other expenses to contra-revenue and of the vendor purchase discount from other incomes to contra-COGS. Under JGAAP, those are reclassified below the operating profit, but in practical terms, are above it. The period covers that after 2004, which might show the effect of the above strategy. Despite LAOX' strategy, both its revenue and its profit went in the wrong direction. Revenue decreased by 92.5% from Y129.1B in 2005 to Y9.7B in 2010. Favorable impacts from focused items' promotion (b), revolution of store floors (b), opening up "resolution-type stores" (c), and introduction of new customer support programs (c) did not materialize, as shown in Table 4.

The cost of goods sold as percentage of revenue fluctuated between 17.0% and 20.2%, probably reflecting the focused items' promotion (b) and the opening up of "resolution-type stores" (c).

Expenses as a percentage of revenue increased significantly from 19.3% in 2005 to 40.0% in 2010. As regards salaries, a favorable impact of early retirement programs (d) must have been included, yet the percentage of salaries against revenue continued to increase from 8.1% in 2005 to 14.6% in 2010. As for rents, a favorable impact of closing stores (e), (f) and (h) must have been included, yet the percentage continued to increase from 3.9% in 2005 to 7.7% in 2009.

As a result, operating losses were incurred from 2007 to 2010. With extraordinary losses from writing off PP&E, LAOX's stockholders equity decreased by 90.6%, from Y37.3B in 2005 to Y3.5B in 2010. Additionally, a going-concern opinion was issued by their external auditor in 2006.

Table 4: LAOX Selected Financials

(Millions of JPY)

	2005	2006	2007	2008	2009	2010	Simple Average
<b>Revenues</b> <sup>(+)</sup>	<b>129,068</b>	<b>103,357</b>	<b>80,635</b>	<b>58,965</b>	<b>40,636</b>	<b>9,684</b>	
Cost of goods sold <sup>(+)</sup>	104,437	82,439	64,902	48,207	33,734	7,912	
<b>Gross margin</b>	<b>24,631</b>	<b>20,918</b>	<b>15,733</b>	<b>10,758</b>	<b>6,902</b>	<b>1,772</b>	
Expenses							
Salaries <sup>(-)</sup>	10,498	8,460	7,042	4,757	4,200	1,412	
Rents	5,015	4,234	4,487	4,273	3,146	678	
Advertisement	1,642	1,169	1,107	987	751	57	
Other expenses	7,708	6,735	6,604	5,974	5,211	1,729	
Total expenses	24,863	20,598	19,240	15,991	13,308	3,876	
<b>Operating profit (loss)</b>	<b>(232)</b>	<b>320</b>	<b>(3,507)</b>	<b>(5,233)</b>	<b>(6,406)</b>	<b>(2,104)</b>	
<b>Extraordinary gain (loss)</b>	<b>(9,928)</b>	<b>(10,561)</b>	<b>(7,143)</b>	<b>(4,307)</b>	<b>(6,644)</b>	<b>(998)</b>	
Percentage of Revenue							
<b>Revenues</b> <sup>(+)</sup>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	
Cost of goods sold <sup>(+)</sup>	80.9%	79.8%	80.5%	81.8%	83.0%	81.7%	
<b>Gross margin</b>	<b>19.1%</b>	<b>20.2%</b>	<b>19.5%</b>	<b>18.2%</b>	<b>17.0%</b>	<b>18.3%</b>	<b>18.7%</b>
Expenses							
Salaries <sup>(-)</sup>	8.1%	8.2%	8.7%	8.1%	10.3%	14.6%	9.7%
Rents	3.9%	4.1%	5.6%	7.2%	7.7%	7.0%	5.9%
Advertisement	1.3%	1.1%	1.4%	1.7%	1.8%	0.6%	1.3%
Other expenses	6.0%	6.5%	8.2%	10.1%	12.8%	17.9%	10.2%
Total expenses	19.3%	19.9%	23.9%	27.1%	32.7%	40.0%	27.2%
<b>Operating profit (loss)</b>	<b>-0.2%</b>	<b>0.3%</b>	<b>-4.3%</b>	<b>-8.9%</b>	<b>-15.8%</b>	<b>-21.7%</b>	<b>-8.4%</b>
<b>Extraordinary gain (loss)</b>	<b>-7.7%</b>	<b>-10.2%</b>	<b>-8.9%</b>	<b>-7.3%</b>	<b>-16.3%</b>	<b>-10.3%</b>	
Common stock	19,011	19,011	19,011	6,000	6,000	2,000	
Additional paid-in capital	20,570	16,286	7,336	22,347	10,826	9,355	
Retained earnings (losses)	(2,066)	(8,013)	(4,355)	(10,348)	(11,386)	(7,422)	
Other stockholder's equities	(199)	14	439	16	(899)	(428)	
<b>Total stockholders' equities</b>	<b>37,316</b>	<b>27,298</b>	<b>22,431</b>	<b>18,015</b>	<b>4,541</b>	<b>3,505</b>	

Notes

(+) Includes reclassifications, mentioned in Financial Results.

(-) Includes bonuses, benefits and retirements.

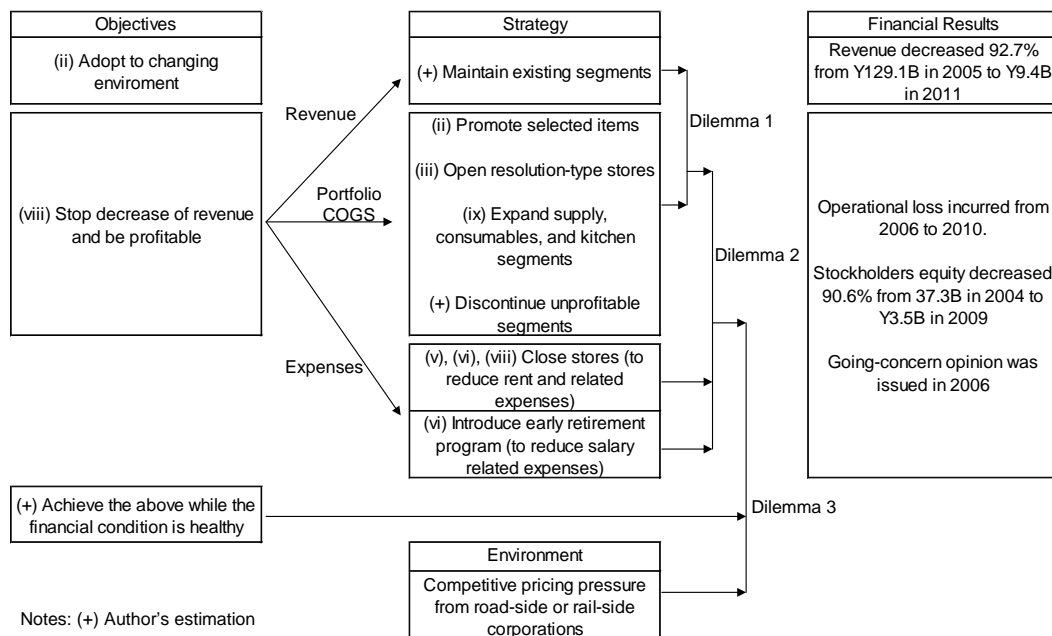
**Dilemma:** Figure 5 summarizes the relationship among LAOX's objectives, strategies, and financial results, as well as possible dilemmas.

The first dilemma might be LAOX could not conduct a drastic restructuring (e.g., discontinuation of certain business or geographic segments) until 2009 due to seeking both revenue and profitability. One option to increase profitability, ignoring the decrease of revenue, could be discontinuation of certain business or geographic segments that were less profitable. Table 5 shows that LAOX did not discontinue any business segments from 2005 to 2008. The largest change in revenue composition was only 5.2% of the PC segment from 20.9% in 2005 to 5.4% in 2008.

The second dilemma might be that LAOX could not drastically close stores (i.e., geographic segment) or reduce the number of associated employees until 2009, also due to seeking revenue.

The third dilemma might be that closing stores and reducing the number of employees took time, while they were simultaneously sustaining pressure from competitors' pricing and their financial condition was worsening. In Japan, the contract term of many commercial facilities is two years and the reduction of employees should be on an agreed-upon basis between employer and employees.

Figure 5: LAOX's Dilemma



**Table 5: LAOX Segment Information**  
(Billions of JPY)

	2006				2009				Changes		
	Revenue <sup>(+)</sup>	COGS <sup>(+)</sup>	Gross margin	Revenue composition	Revenue <sup>(+)</sup>	COGS <sup>(+)</sup>	Gross margin	Revenue composition		Revenue composition	
Home appliances											
TV	10.9	9.0	1.9	17.3%	10.5%	5.0	4.0	1.0	19.1%	12.3%	1.8%
Video	7.7	6.5	1.2	15.1%	7.4%	2.9	2.4	0.5	17.0%	7.1%	-0.3%
Audio	6.8	5.6	1.2	17.0%	6.6%	2.3	1.8	0.6	23.9%	5.7%	-0.9%
Refrigerator	3.3	2.5	0.8	25.0%	3.2%	1.4	1.2	0.2	14.1%	3.5%	0.3%
Washing machine	4.0	3.0	1.0	25.7%	3.9%	1.6	1.4	0.2	11.1%	3.9%	0.1%
Cooking	7.7	5.7	2.0	25.4%	7.4%	3.8	2.7	1.1	28.1%	9.4%	1.9%
Air conditioning	5.9	4.6	1.3	22.8%	5.7%	2.9	2.4	0.5	17.0%	7.1%	1.4%
Total H&A	46.3	36.9	9.4	20.2%	44.8%	19.9	16.0	3.9	19.8%	49.1%	4.3%
Consumer electronic											
PC	11.0	10.4	0.6	5.5%	10.6%	2.2	1.8	0.5	20.5%	5.4%	-5.2%
Referral	16.9	13.8	3.1	18.6%	16.3%	4.7	3.8	0.9	18.6%	11.6%	-4.8%
Software	4.4	3.7	0.7	16.7%	4.3%	1.5	1.2	0.3	19.8%	3.7%	-0.6%
Telephone	3.1	1.9	1.2	39.3%	3.0%	2.4	2.2	0.2	8.9%	5.9%	2.9%
Others	19.8	15.4	4.4	22.0%	19.1%	9.6	8.5	1.1	11.1%	23.7%	4.5%
Total Information	55.2	45.1	10.0	18.2%	53.4%	20.4	17.5	2.9	14.2%	50.3%	-3.1%
Others	1.9	0.4	1.5	79.2%	1.8%	0.3	0.2	0.1	19.8%	0.7%	-1.1%
Total	103.4	82.4	20.9	20.2%	100.0%	40.6	33.7	6.9	17.0%	100.0%	0.0%

**Notes**

(+) Includes reclassifications, mentioned in Financial Results.

### SECTION III – IMPLICATIONS

The author understands that this study has several limitations. First, only two corporations' cases were studied. Second, no internal information or confirmation was obtained, and only public information was used. Third, the author used a certain definition and some presumptions. Despite such limitations, the author considers the following to be the implications to be drawn from this study with regard to transformation of strategy into financial results.

- The simpler or less abstract a corporate strategy is, the better or more predictable the financial results are.
- If structural level issues are dealt with at a higher level of the management process (i.e., strategic planning rather than operational planning, operational planning rather than implementation), the likelihood of the above transformation will be increased.

AMZN's long-term goal was clearer and non-abstract, mentioning the prioritizations of growth(of revenue) and long-term free cash flow rather than short-term profitability from its inception. LAOX's objective was abstract (i.e., adapting to the changing environment) in 2005 and 2006 and became specific (i.e., maintaining its revenue and becoming profitable) in 2007, by which time their revenue had been decreasing for 6 years. The author also considers that seeking both revenue and profitability was optimistic. LAOX's average percentage of expenses per revenue from 2004 to 2010 was 27.2%. Generally, for road-side or rail-side corporations, it was less than 15%, as they took advantage of large-scale, fewer-floored, lower-cost operations. Such a gap between LAOX and road-side or rail-side corporations does not seem to have been filled by efforts in operational planning and implementation.

AMZN's strategy stayed at a relatively high level, whereas LAOX's strategy itemized relatively minor items. Possibly LAOX's strategy had the three dilemmas mentioned earlier.

The two implications above stem from the author's experience as regional Chief Financial Officer at NASDAQ corporations over the past 10 years. For example, when he visited several countries for annual budgeting processes, he was surprised to see so many different interpretations of a corporate strategy and made efforts to correct them.

He also observed that the degree of success of the transformation becomes more visible when the economy is sluggish. When the economy is growing, financial results tend to be better and few questions arise as to whether this is due to a successful transformation of the corporation's strategy. But when the economy is sluggish, competition becomes tougher and the corporation faces a lot of resource limitations. When the corporation's strategy deals with structural issues, the financial results are generally as expected.

In this way, he believes that this study would be useful, especially in the current sluggish economy. He also hopes that this study would be improved and developed by examining more relevant cases, reducing its limitations and widening its scope.

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## 〔抄録〕

本稿は企業戦略の財務業績への変換について探求し、学術的分類は単体としての会計学、経営学、経済学のいずれにも属しない。この探求は、重要かつ有意義である。なぜなら、優れた戦略の策定が、必ずしも優れた財務業績につながるとは限らないからである。企業活動の中で、戦略が誤解、無視される事は珍しい事ではなく、又、企業戦略の財務業績への変換過程では、濃縮化ではなく、希薄化が起こる事が一般的である。

本探求には、2つの大きな障壁が存在した。一つは、企業活動全てを把握しようとする対象範囲が大きくなりすぎる事、もう一つは、戦略、予算等の企業内部情報を入手する事が困難な事である。しかし、対象範囲を絞り、いくつかの定義と仮定を適用する事により、この障壁は克服された。

本稿では、米国、日本における上場小売企業2社のケースを取り扱い、企業戦略、財務業績を対比させながら考察を進めた。そこから推論された結果は、下記のとおりである。

- 企業戦略がより単純、非抽象的であれば、より意図した財務業績に変換される確率が高まる
- 根本的問題が経営管理プロセスの、より上流(例：実施計画レベルでなく、戦略計画レベル、実施レベルでなく実施計画レベル)で対処されれば、更に上記の確率が高まる