



CAMPUS RECRUITING

# 2010 KPMG International Case Competition

November 19, 2010

KPMG LLP

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# GOAL IS TO MAINTAIN PROFITABILITY.

- How has Sony performed over the past few years?
- How has Sony's performance impacted the bottom line?
- What improvements can we make to Sony's business model?

## Overview

### Analysis

- External
- Internal

### Financials

### Recommendation

- Develop
- Diversify
- Discount

### Considerations

# DISCOUNT TO MAINTAIN STEADY PROFIT.

Product-centric model and sensitivity to macro events hurt Sony.



During 2008-09, net income fell by ¥468B.



Low-budget product lines will raise profit margin and hedge against recessions.

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# SWOT

## Strengths

- Innovative culture
- High-quality products

## Weaknesses

- Unperfected process
- Frequent restructuring

## Opportunities

- Demand for low-budget products
- Expected electronics revolutions

## Threats

- Exchange rates
- Economic situation in US and Japan
- Tokyo culture

Overview

## Analysis

- External
- Internal

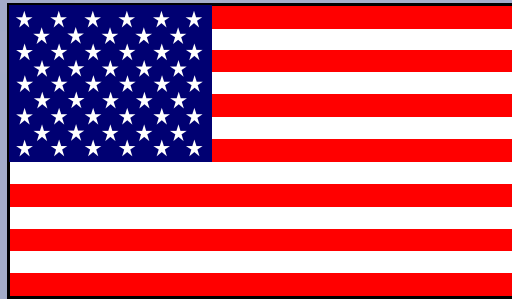
Financials

Recommendation

- Develop
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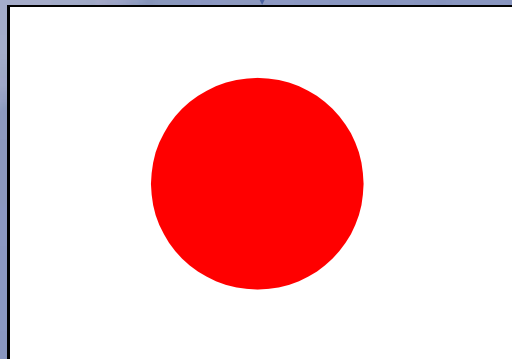
Considerations

# MANY MACRO EVENTS HURT SONY.



**Recession:**  
Demand for cheap products hurts sales.

**Exchange rate:**  
Loss on foreign currency conversion.

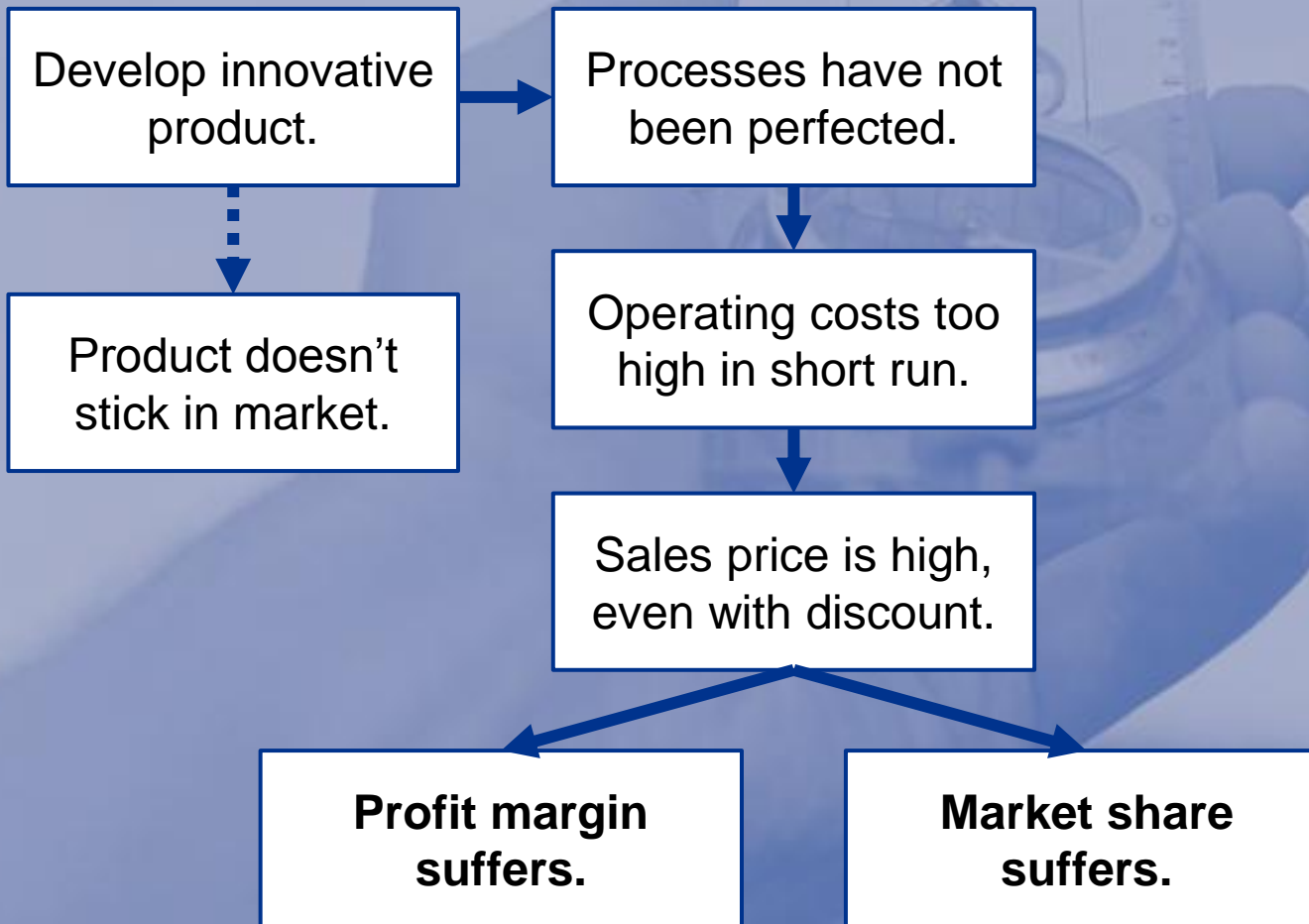


**Tokyo Culture:**  
Social norms may inhibit effective organizational change.

Overview  
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[Source 4](#)

# PRODUCT-CENTRIC MODEL HURTS SONY.



Overview

**Analysis**

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- **Internal**

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Source 1

Source 2

Source 3

Source 4

# NUMBERS SUPPORT INITIAL ANALYSIS.

	(In Millions of Yen)				
For the Year Ended March 31	2005	2006	2007	2008	2009
<b>Sales and Operating Revenue</b>					
Japan			¥2,127,841	¥2,056,374	¥1,873,219
USA			¥2,232,453	¥2,221,862	¥1,827,812
Europe			¥2,037,658	¥2,328,233	¥1,987,692
Other			¥1,897,743	¥2,264,945	¥2,031,270
<b>Total Sales and Operating Revenue</b>	<b>¥ 7,191,325</b>	<b>¥ 7,510,597</b>	<b>¥8,295,695</b>	<b>¥8,871,414</b>	<b>¥ 7,729,993</b>
<b>Operating Expenses</b>					
Cost of Goods Sold	¥ 5,033,928	¥ 5,257,418	¥5,806,987	¥6,209,990	¥ 5,410,995
R&D	¥ 491,166	¥ 508,970	¥ 573,550	¥ 536,800	¥ 500,000
Other Operating Expenses	¥ 1,491,564	¥ 1,504,617	¥1,764,755	¥1,649,395	¥ 2,046,781
<b>Total Operating Expenses</b>	<b>¥ 7,016,658</b>	<b>¥ 7,271,005</b>	<b>¥8,145,291</b>	<b>¥8,396,185</b>	<b>¥ 7,957,776</b>
Operating Income (loss)	¥ 174,667	¥ 239,592	¥ 150,404	¥ 475,229	<b>¥ 227,783</b>
Other Income Minus Other Expenses	¥ 11,579	¥ 59,914	¥ 30,287	¥ 91,905	¥ 52,828
<b>Total Income (Loss) Before Taxes</b>	<b>¥ 186,246</b>	<b>¥ 299,506</b>	<b>¥ 180,691</b>	<b>¥ 567,134</b>	<b>¥ 174,955</b>
Taxes on Operating Income	¥ 62,181	¥ 85,295	¥ 53,544	¥ 169,182	<b>¥ 81,091</b>
Taxes on Other Income	¥ 4,122	¥ 21,329	¥ 10,782	¥ 32,718	¥ 18,807
Net Payment of Deferred Taxes minus Deductions and new Deferrals	<b>¥ 50,260</b>	¥ 69,891	<b>¥ 10,438</b>	¥ 1,578	<b>¥ 10,457</b>
<b>Total Taxes</b>	<b>¥ 16,044</b>	<b>¥ 176,515</b>	<b>¥ 53,888</b>	<b>¥ 203,478</b>	<b>¥ 72,741</b>
Net Income Attributable to Operations	¥ 112,486	¥ 154,297	¥ 96,860	¥ 306,047	<b>¥ 146,692</b>
<b>Total Net Income</b>	<b>¥ 163,838</b>	<b>¥ 123,616</b>	<b>¥ 126,328</b>	<b>¥ 369,435</b>	<b>¥ 98,938</b>

Overview  
Analysis

- External
- Internal

**Financials**

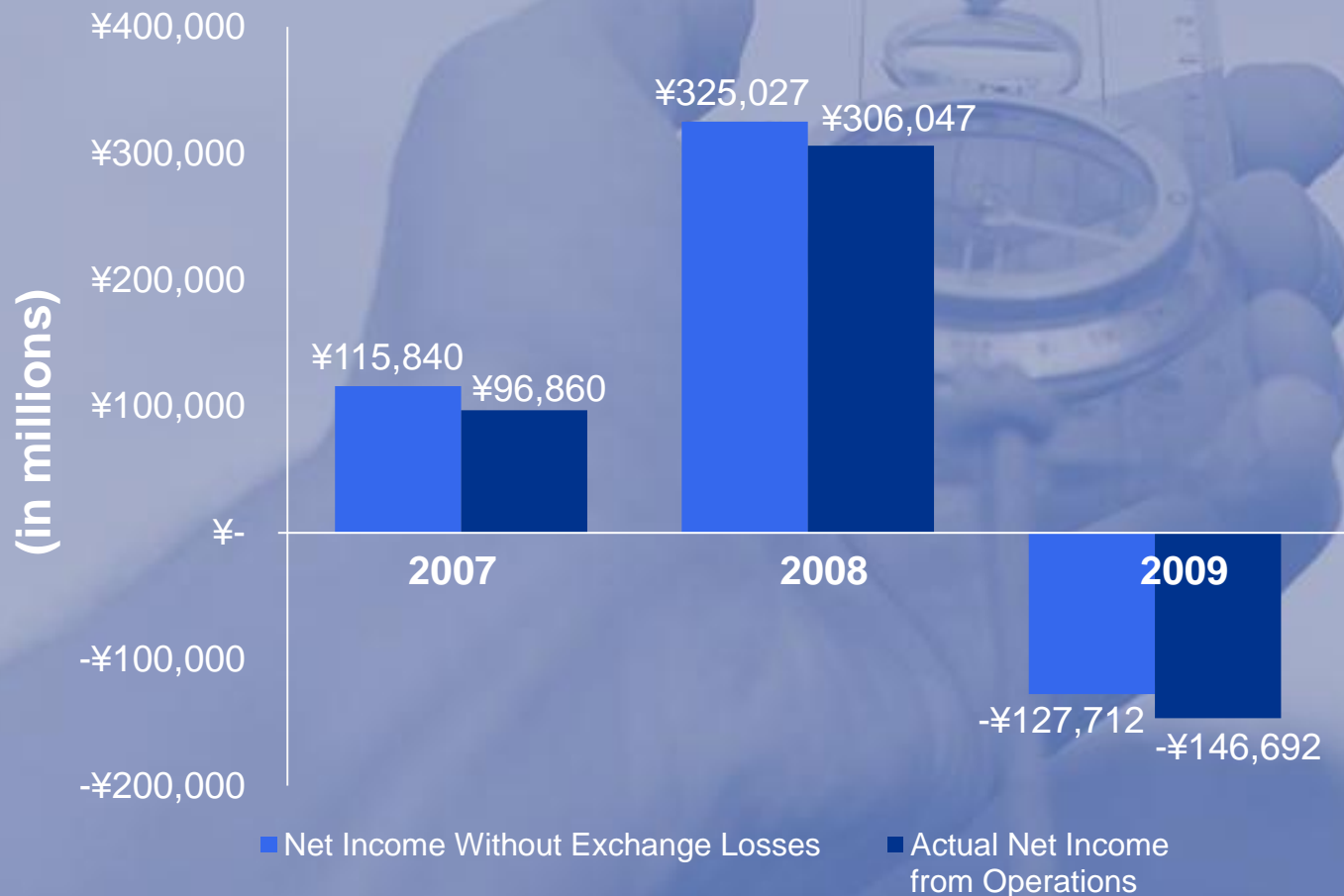
Recommendation

- Develop
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Considerations

[Source 1](#)  
[Source 2](#)  
[Source 3](#)

# AVERAGE ¥19B LOSS ON CONVERSION.

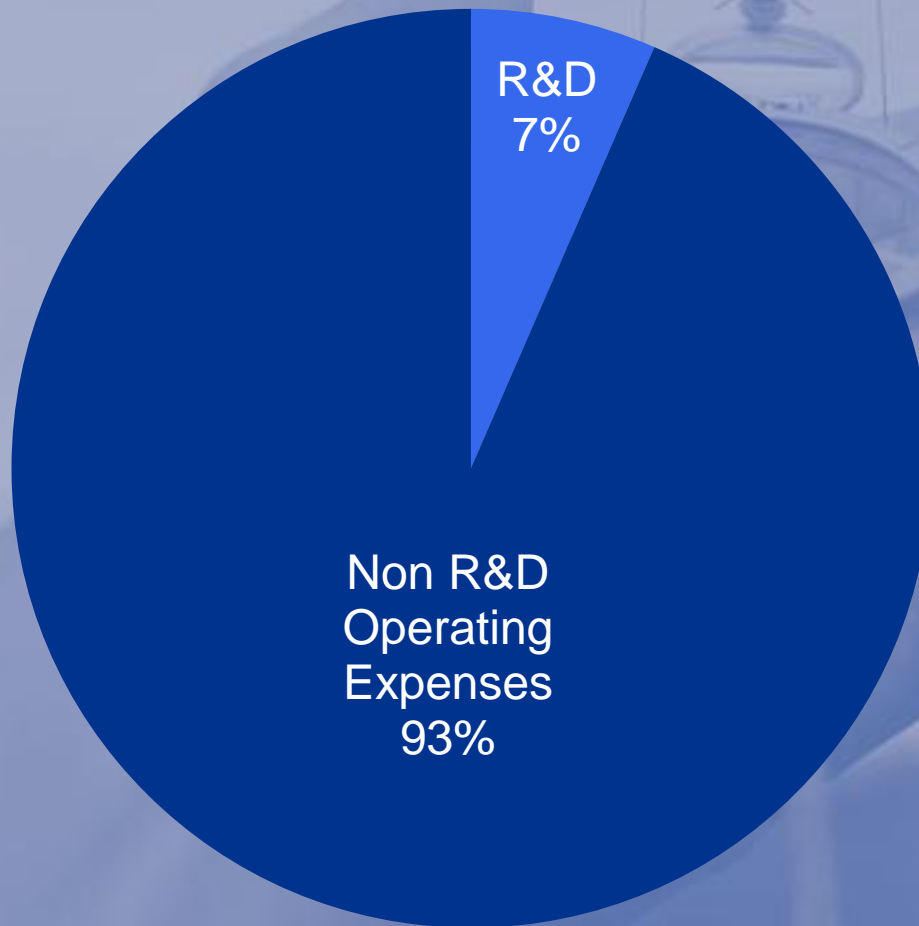


Overview  
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[Source 1](#)  
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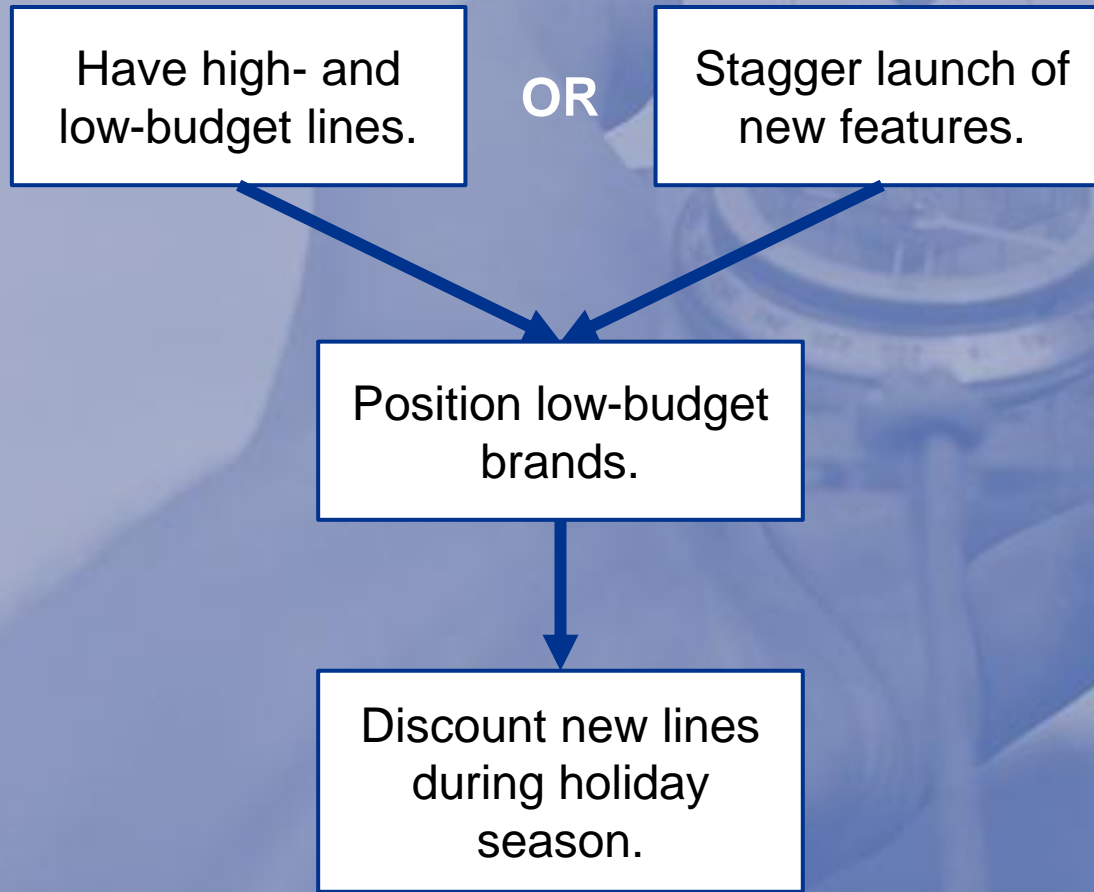
# R&D IS NOT A SIGNIFICANT COST DRIVER.



- Overview
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Source 1

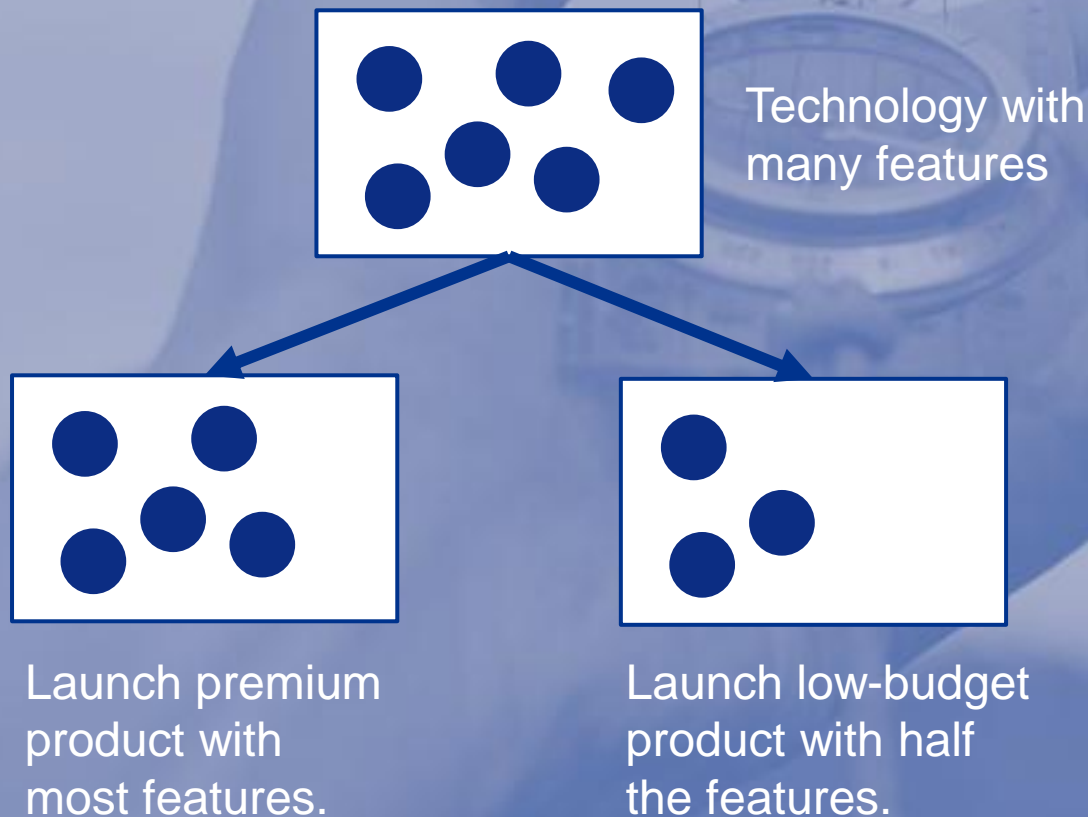
# LAUNCH LOW-BUDGET PRODUCT LINES.



- Overview
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# HAVE HIGH- AND LOW-BUDGET LINES.

For existing technology,



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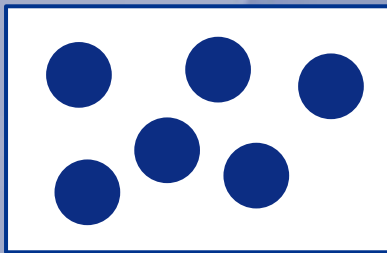
**Recommendation**

- **Develop**
- Diversify
- Discount

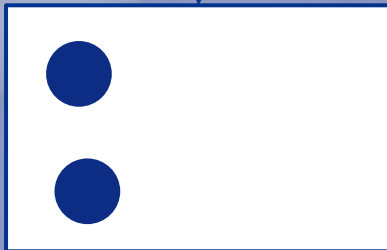
Considerations

# STAGGER LAUNCH OF NEW FEATURES.

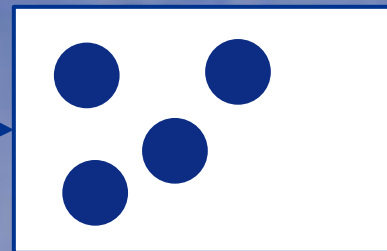
For new technology,



Develop technology with many features.



Launch product with most basic features.



Add features in each iteration of product.

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**Recommendation**

- **Develop**

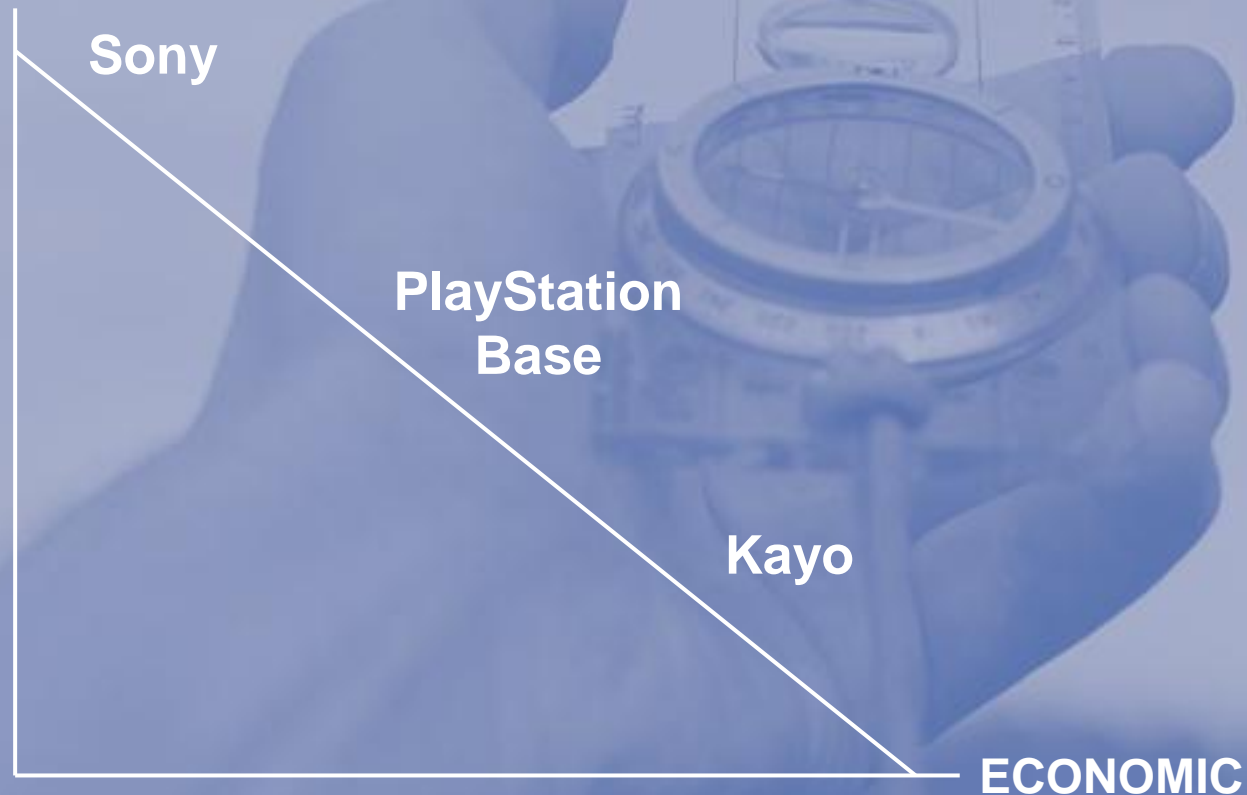
- Diversify

- Discount

Considerations

# POSITION LOW-BUDGET BRANDS.

FEATURES



- Overview
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  - **Diversify**
  - Discount
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# DISCOUNT NEW LINE DURING HOLIDAYS.

Discount

Profit

Costs

**PREMIUM**

Lower initial price.

Higher Discount

Profit

Lower Costs

**LOW-BUDGET**

Lower costs mean higher discount does not hurt profit margin.

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Source 1

# COMPETITOR AND EROSION CONCERNS.

## What if competitors do the same thing?

- **Small firms:** will not beat us in a price war
- **Large firms:** innovate quickly, partner with distributors and retailers

## What about erosion?

Industries are developed and segmented, so launching a low-budget brand will not impact existing sales greatly.

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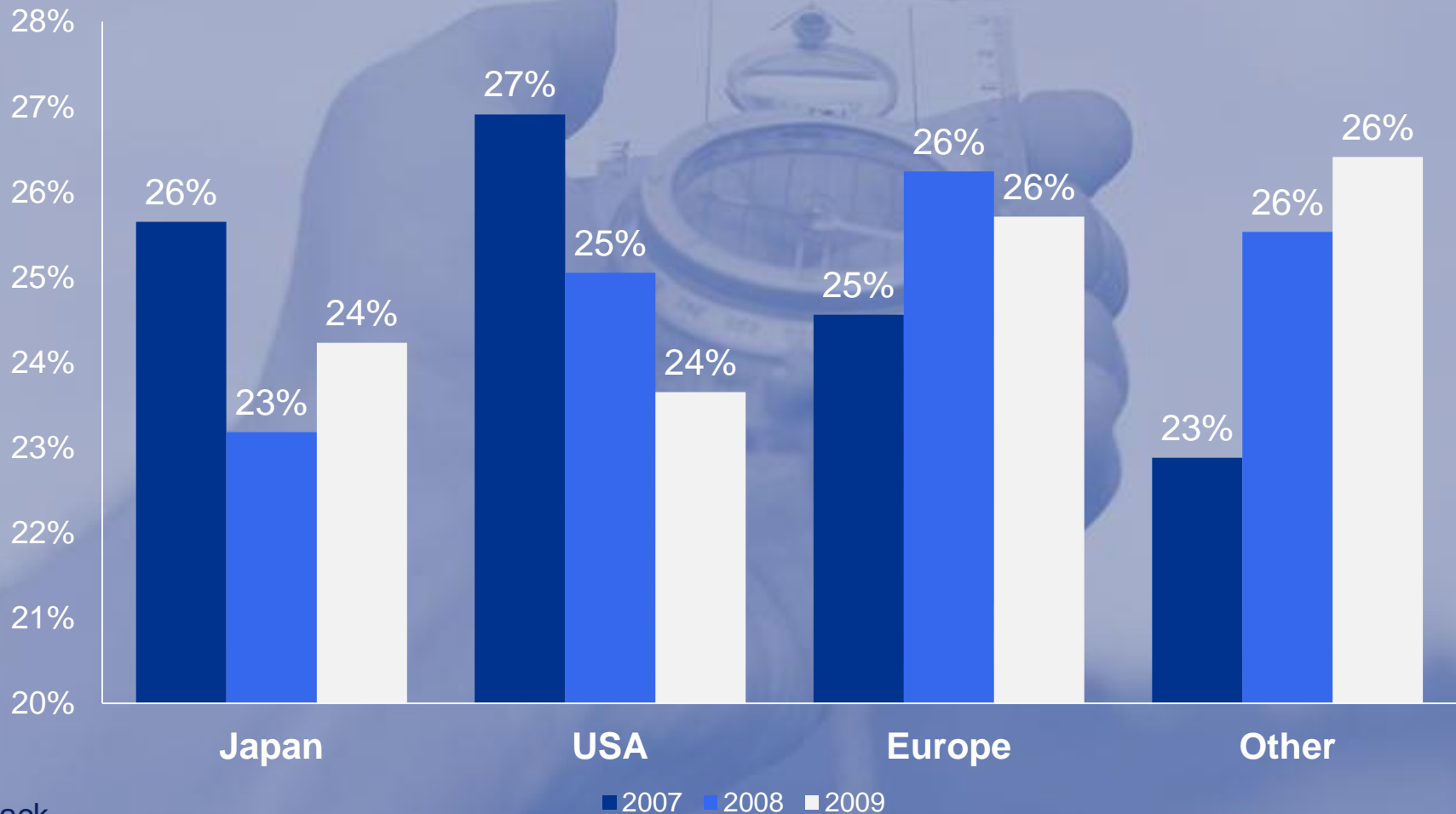
# Supplements

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# RELATIVE SALES FOR US FELL IN 2008-09.



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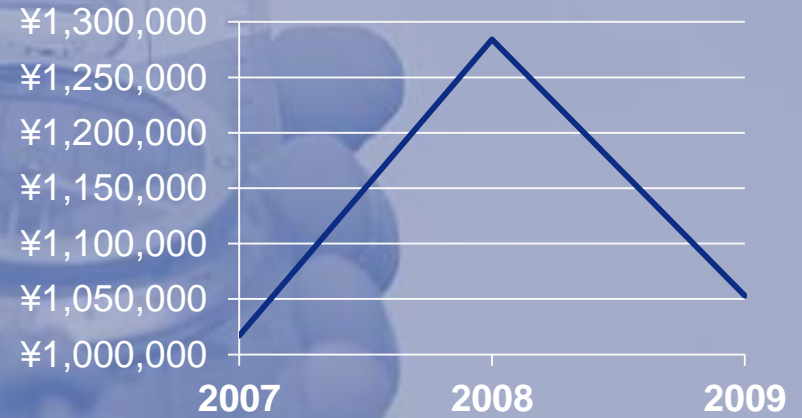
# US RECESSION HIT SALES SHARPLY.

REVENUE

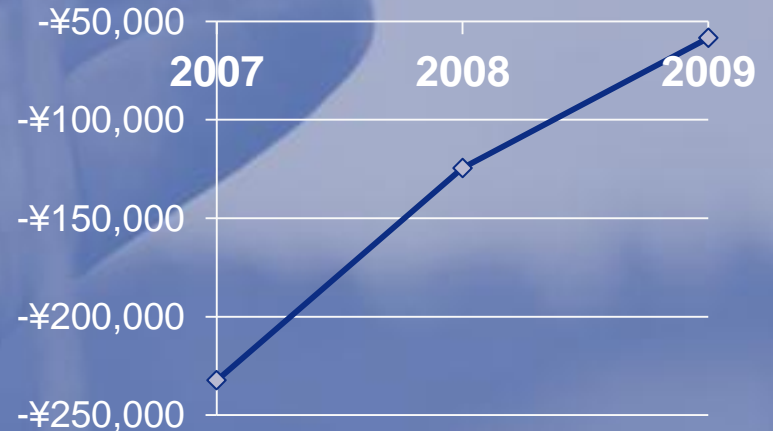
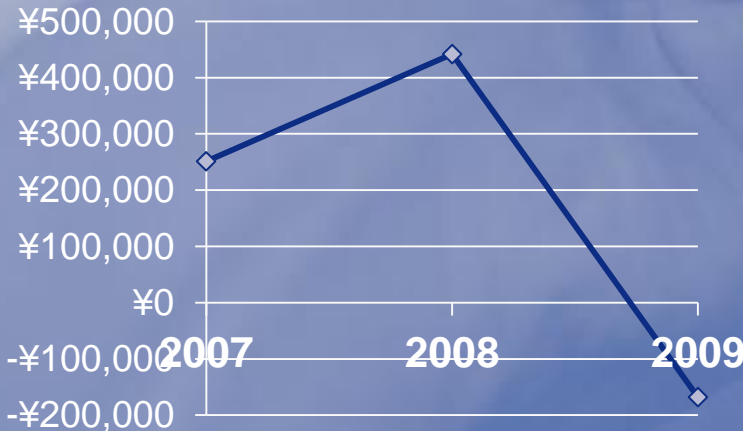
## Electronics



## Games



PROFIT



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# SUPPORT FOR MACRO SENSITIVITY

- P.1 Annual sales in 2009 going down by 12.9% to 7.73 trillion yen.
- P.1 Sony also warned that with consumers worldwide cutting back on spending in light of the recession, the losses could be to the extent of 120 billion yen for the year ending march 2010
- P.4 Despite the increase in revenue due to higher sales of the PlayStation, net income dropped to 16.75 yen billion as compared to 121.83 billion yen the previous year. The drop in net income was attributed to a decline in demand for computer-related products due to a slowdown in the IT industry

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# SUPPORT FOR MACRO SENSITIVITY

- P.6 Though the successful restructuring and the devise of Bravia television boosted 07-08 profit, consumers postponed the purchase of electronics products during the recession and because of the strengthening of the Yen
- P.7 The company said the global economic downturn could impact the sales of LCD televisions and digital cameras

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# SUPPORT FOR TOO PRODUCT-FOCUSED

- P.2 The company firmly believed that there was a huge demand for such products and did not attach much importance to market research
- P.2 Sony focused on product innovation and on offering high quality products
- P.5 In fiscal 2006, the TV division still showed losses as the company had spent heavily on advertising and had lowered prices in its race against competitors like Samsung and LG.

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# SUPPORT FOR TOO PRODUCT-FOCUSED

- P.6 Sony's management remained confident that its television unit would turn profitable. E.g. The OLED television failed to make its presence felt in the US market, as it was priced at US\$ 2042 for an 11 inch model
- P.7 In second quarter of 2008-2009, Sony posted a decrease of 52.8b yen in net profit ~ US\$ 558m, conservatively 22% contributed by PS3 (total loss from PS3 in 2008 is  $(448-399) \times 10m \times 0.25 = \text{US\$ } 122.5m$ , assuming the sale of PS3 is uniform through the whole year)

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# EXAMPLES OF RESTRUCTURING LOSS

1994 [P.1]: reported a loss of 293.36 billion in 1995

1996 [P.3]: did not lead to any sustainable improvement in the company's financial performance; net income dropped by 19.4%

1999 [P.4]: net income fell to 121.83 billion yen, a decline of over 58 billion yen as compared to the previous year

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# EXAMPLES OF RESTRUCTURING LOSS

2001-2002 [P.4]: Operating income declined by 40.3% while revenues increased by 3.6%. In Apr 2003, Sony announced its quarterly results, reporting a quarterly operating loss of 116.5 billion yen. For the quarter ending June 2003, Sony reported a net income of 1.1 billion yen which was 98% lower as compared to the profit of 57.2 billion yen reported in the corresponding quarter in fiscal 2002.

Oct 2003 – Oct 2006 [P.4]: Transformation 60; cost: US\$ 3.1 billion

Sept 2005 [P.1]: benefit: sales and operating revenue grew by 10.5% in March 07 and 6.9% in Mar 08.

Feb 2009 [P.2]: Benefit: reduced cost by US 2.5 Billion

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# OPERATING LOSS OF PLAYSTATION 3.

By December 2008:

Price of PlayStation 3: \$399

Manufacturing Cost of PlayStation 3: \$448

Consoles sold in 2008: 10 Million

Operating loss incurred from selling PlayStation 3 in 2008:

$$(399 - 448) \times 10 \text{ Million} = - 490 \text{ Million Dollars}$$

Exchange Rate: 1 Dollar = 100 Yen

Total operating loss incurred in Yen:

$$100 \times (- 490 \text{ Million}) = - 49,000 \text{ Million}$$

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# ESTIMATION

<b>Electronics Division</b>	2007	2008	2009	Total
Revenue	5443336	5931708	5032920	
Net Income	251256	441787	58476	
Total Expenses	5192080	5489921	4974444	
Electronics' Cost of Goods Sold	3634456	3842944.7	3482110.8	
Other Electronic Expenses	1557624	1646976.3	1492333.2	4696933.5
Sony's Total Other Expenses	1764754.5	1649395.2	2046780.9	5460930.6
	86% of Goods and R&D Expenses			

Electronics Workers	160,000	
Total Sony Workers	186,000	=160,000/86%
Electronics Plants	49	86% of 57
Total Sony Plants	57	

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# TAX ASSUMPTIONS

Tax Assumptions	2005	2006	2007	2008	2009	Total
Income (loss) before income taxes	¥186,246.00	¥299,506.00	¥180,691.00	¥567,134.00	-¥174,955.00	¥1,058,622.00
Income Taxes	¥16,044.00	¥176,515.00	¥53,888.00	¥203,478.00	-¥72,741.00	¥377,184.00
					Tax Rate	36%

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# CONVERSION ASSUMPTIONS

We're given the following information in the case:

	October 1st, 2008	August 31st, 2009
Conversion Assumptions	100 Yen/Dollar	93.25 Yen/Dollar

Therefore Yen grew stronger by 6.75 Yen/Dollar over 11 months, equivalent to a rate of .614 Yen/Dollar per month.

From this we estimate the following:

Yen was at 103.68 Yen/Dollar at April 1st, 2008, and at 96.31 Yen/Dollar at March 31st, 2009

So average Yen/Dollar for the Financial Year ending March 31st, 2009 is 100 Yen/Dollar.

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# CONVERSION ASSUMPTIONS

Extrapolating back, we get 111.05 Yen/Dollar at April 1st, 2007, 118.37 Yen/Dollar at April 1st, 2006

This gives us an average of 107.36 Yen/Dollar for the Financial Year ending March 31st, 2008, and 114.71 Yen/Dollar for the Financial Year ending March 31st, 2007.

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# CONVERSION ASSUMPTIONS

Annual Operating Losses on Exchange Rate = .614 Yen  
Increase/month  $\times$  12 months/year  $\times$  4 Billion Yen per  
Increase of Yen

Annual Operating Losses on Exchange Rate = .614 Yen  
Increase/month  $\times$  12 months/year  $\times$  4 Billion Yen per  
Increase of Yen

Annual Operating Losses equal 29.47 billion Yen per year

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# EFFECT OF EXCHANGE ON NET INCOME

Effect of Exchange Rate On Net Income				
	In Millions of Yen			
	2007	2008	2009	
Losses from Exchange Rate	-¥ 29,472	-¥ 29,472	-¥ 29,472	
Operating Income	¥ 150,404	¥ 475,229	-¥ 227,783	
Operating Income Without Exchange Losses	¥ 179,876	¥ 504,701	-¥ 198,311	
Taxes on Adjusted Operating Income	¥ 64,036	¥ 179,674	-¥ 70,599	
Net Income Without Exchange Losses	¥ 115,840	¥ 325,027	-¥ 127,712	
Actual Net Income from Operations	¥ 96,860	¥ 306,047	-¥ 146,692	
Effect of Exchange Rate On Net Income	-¥ 18,980	-¥ 18,980	-¥ 18,980	

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# R&D EXPENSES

	<b>R&amp;D</b>	<b>Non R&amp;D Operating Expenses</b>
<b>2007</b>	¥573,550.00	¥7,722,145.00
<b>2008</b>	¥536,800.00	¥7,859,385.00
<b>2009</b>	¥500,000.00	¥7,457,776.00
<b>Total</b>	¥1,610,350.00	¥23,039,306.00

On average, R&D expenses is about 7% of total operating expenses.

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# SUPPORT FOR HOLIDAY DISCOUNT NEED

P.7 Analysts said that the company, which had posted a profit during the first half of 2009, had failed to take advantage of the holiday season in the US. The discounts it had given were not adequate while the competitors had resorted to more aggressive price cuts.

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