

Common size and your assignment

Common size is a very helpful technique for identifying trends and changes in your company. It can be used on any of the three financial statements. Its value is that it is much easier to see trends and changes in percentage terms than in raw numbers. Therefore, the technique makes it easier to compare a company's performance over time and to compare two or more companies, especially companies of different sizes.

To get a sense of how your company is performing compared to others in the same industry, you also can look at industry averages. Industry averages are especially helpful if they are broken into groups by revenues or some other important metric for the industry. If your company were Nordstrom, you would find it helpful to see how Nordstrom's performance compared with other clothing retailers.

Calculating Common Size for the Income Statement is simple – divide revenues (sales or net sales on some Income Statements) into all of the other entries on the statement. Unfortunately, occasionally this can be a bit confusing since not all Income Statements use the same titles for entries, some leave out terms and some lump entries together.

So, to have a meaningful Common Size analysis, we need to reorganize Income Statements into the categories and format we've been learning in class. The usual problem occurs when entries appear "inside the box" that we've said need to be "outside the box." It generally requires seeing a number of these entries before you are comfortable in determining if something should go "in the box" or in the category "Other" or "Other revenues and expenses."

In addition, if you want to simplify a Common Size analysis (for purposes of this class), you can round your dollar amounts down by the final three zeroes on every entry. If you do that, you would need to make sure you had something like "Amounts in millions" at the upper left of the master sheet.

Assignment

For Friday's session, you will do a Common Size on the Kellogg Income Statement. You will use the file entitled Kellogg first '10, which gives you Kellogg's Income Statement for the past five years in an Excel spreadsheet. Note that the columns after each year's numbers are empty. This is where you will put the percentages you calculate for each category of the Income Statement.

If you are too busy to calculate all of the categories for each year, calculate the figures for Gross Profit, Operating Profit and Net Income Attributable to Kellogg Co.

After you have calculated the numbers, try to interpret their meaning. For example, look at how Net Income Attributable to Kellogg Co. has moved over the five years from 2005 to 2009. You can draw some inferences by looking at how the Gross and Operating profit numbers move over the same period.

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