**GEMBA XI – Theme 8A**

**Strategic Planning for Growth and Profitability**

**17 – 21 September 2015, Shanghai Jiao Tong University, Shanghai**

**Professors Arvind Bhambri (Strategy) and Julia Plotts (Finance)**

**All assigned readings and cases for all the week's sessions need to be read and studied before the first session at SJTU. Focus on reading and being prepared to discuss.**

In different ways, you have been discussing strategy and strategic decisions in all themes of GEMBA. In themes 8A and 8B, we will integrate prior concepts and introduce some new concepts of strategic decision-making. We will also focus on dynamics of development and execution rather than on static analysis. In particular, we will discuss the advantages and limitations of the various strategy frameworks and practice their application to major strategic decisions and cross-border transactions (merger, acquisition, divestiture) to evaluate whether the transaction creates shareholder value.

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**Thursday, 17 September**

**07:30 Breakfast**

**08:30 Strategy Session 1** – **Professor Bhambri**

**Topic: Strategic Thinking**

**Required review:**

*Review your notes from strategy and leadership, especially with Professors Voigt and Blumenthal and reflect on the following questions:*

**Questions:**

1. What is effective strategic thinking?
2. Which frameworks are easy to practice? Why?
3. Which frameworks are difficult to practice? Why?

**Topic: Competitive Dynamics**

*After a brief review, we will start theme 8 with a discussion of competitive dynamics, namely, how companies anticipate and counter expected competitive actions. Strategy is not developed or executed in a vacuum. The results of any strategy depend to a significant extent on how competitors retaliate. By the same token, companies attempt to signal, pre-empt, and otherwise influence the responses of its competitors. We will look at one of the most intensely competitive industries, the airline industry, and we will see what we can learn about competitive dynamics from the experience of a “start-up” in this industry. We will continue our study of competitive dynamics through tomorrow.*

**Sub-topics:**

* Competitive Dynamics
* First Mover and Second Mover Advantages
* Competitive Moves and Signals
* Competitor Analysis and Profiling
* Anticipating Competitor Actions

**Required Readings:**

* Case: Dogfight Over Europe: Ryanair (A) HBS #9-700-115
* Article: Global Gamesmanship, HBR R0305D

*This case, set in 1986, is a business school classic. It describes Ryanair’s initial launch strategy. Ryanair must compete with established companies like Aer Lingus and British Airways that will likely retaliate against Ryanair. This case gives us a chance to explore Ryanair’s strategy, positioning, and sustainability through a series of cases that we will discuss over two days.*

**Case Discussion Questions:**

1. What is your assessment of Ryanair’s launch strategy?
2. How do you expect Aer Lingus and British Airways to respond? Why?
3. How costly would it be for Aer Lingus and British Airways to retaliate against Ryanair’s launch rather than to accommodate it?
4. Can the Ryan brothers make money at the fare they propose?

**9:45 Break**

**10:00 Strategy Session 2 – Professor Bhambri**

**Topic: Competitive Dynamics & Interaction (1)**

*We will continue our discussion of RyanAir and use it to distill key lessons on competitive dynamics and capabilities.*

**11:15 Break**

**11:30 Strategy Session 3 – Professor Bhambri**

**Topic: Competitive Dynamics & Interaction (2)**

*We will continue our discussion of RyanAir and use it to distill key lessons on competitive dynamics and capabilities.*

**12:45 Lunch**

**13:45 Theme 8 Finance Introduction – Professor Plotts**

**Required review:**

*Review your Ross Westerfield Jaffe text (Corporate Finance) textbook from Themes 2-3 finance with Professors Campbell and Swartz. Theme 8 assumes a basic foundation or understanding of the following concepts:*

**Accounting:**

* Review the financial statements and how they inter-relate, financial ratios, calculation of free cash flow (understand working capital, depreciation, capital expenditures).

**Finance:**

* Time Value of Money: present value, future value, annuities, perpetuities
* Capital Budgeting: Net Present Value (NPV), Internal Rate of Return (IRR) payback
* Other: stock and bond valuation, risk and reward, CAPM model, Weighted Average Cost of Capital (WACC)

*This session will provide an overview of the finance content covered in Theme 8. We will discuss the importance of fundamental analysis in evaluating firms and their ability to create value for shareholders. In Themes 2-3 Finance we have discussed the firm’s objective to maximize returns for shareholders by increasing the intrinsic value of the business. Maximizing shareholder value involves managing firm performance in the short term and also long-term health.*

*The financial strategy sessions will involve applying tools of financial analysis and valuation methodologies to evaluate a company’s strategic and competitive positioning, financial performance, and strategic alternatives. Discounted Cash Flow (DCF) analysis is a key building block for valuation. During our financial strategy sessions we will review time value of money fundamentals from financial management and will discuss enterprise (firm) valuation. An important aspect of the sessions will be to bridge financial theory and practice with valuation, capital structure analysis, and corporate strategy in the context of real world implications.*

**14:00 Finance Session 1 – Professor Plotts**

**Topic: Foundations of Value**

**Required Readings:**

* Review Online article “Creating value: An interactive tutorial” November 2010[[1]](#footnote-1) <http://tinyurl.com/qd5hdnf> In this video presentation, McKinsey partner Tim Koller explores the four guiding principles of corporate finance that all executives can use to home in on value creation when they make strategic decisions. (If you don’t have time to watch the entire video it would be helpful to watch the first two segments: 1) The four cornerstones of corporate finance and 2) the Core-of-value principle
* Review online book excerpt from *McKinsey Quarterly*, “What is value-based management?” An excerpt from *Valuation: Measuring and Managing the Value of Companies,* August 1994, Timothy Koller. <http://tinyurl.com/pc4f4ln>
* Review online book excerpt from *McKinsey Quarterly*, “Measuring long-term performance: Earnings per share and share prices aren’t the whole story—particularly in the medium and long term.” March 2005 Richard Dobbs and Timothy Koller <http://tinyurl.com/pk5jv6u>

**Learning Objectives:**

*Understand that the goal of the firm is value creation. Return on capital and growth drive value creation. Value creation is fundamentally more important than that of growing revenues, earnings per share, maximizing volume and/or market share. Firms create value by investing capital in positive net present value (NPV) projects.*

**15:00 Break**

**15:15 Finance Session 2 – Professor Plotts**

**Topic: Foundations of Value (continued)**

**16:30 Break**

**16:45 Joint class session with G-XII**

**18:00 Joint pub session**

**Friday, 18 September**

**07:30 Breakfast**

**08:30 Strategy Session 4 – Professor Bhambri**

**Topic: Competitive Dynamics & Interaction (3)**

*We will deepen our understanding of competitive interdependence and interaction by examining different industries and companies. We will also examine how competitive interactions play out over several years. Starting with strategic decisions facing Airbus and Boeing in 1992, we will look at how early decisions can shape the future of a company.*

**Required Reading:**

* Case: Airbus vs.Boeing (A) HBS #9-707-447)

**Case Discussion Questions:**

1. What are the drivers of value creation and value capture in this industry?
2. As of 1992, who is doing better - Airbus or Boeing? Explain why.
3. What would be the value of a new VLCT to both companies?
4. If you were Airbus, how would you respond to Boeing? Should Airbus collaborate with Boeing in the development of the new VLCT?

**09:45 Break**

**10:00 Strategy Session 5 – Professor Bhambri**

**Topic: Competitive Dynamics (4)**

*We will build on our understanding of competitive interaction by examining how different business models interact.*

**Required Readings:**

* Case: eBay, Inc. and Amazon.Com (A), HBS #9-712-405

**Case Discussion Questions:**

1. What are the key drivers of profitability in eBay’s business model?
2. What are the key drivers of profitability in Amazon’s retail business model? How does this retail business model interact with that of eBay?
3. As it shifted to a retail and platform business model, how successful was Amazon in overcoming barriers to entry in the third party seller’s market? What business choices were critical in altering the competitive dynamic?
4. What would you recommend for eBay going forward, and why?

**11:15 Break**

**11:30 Strategy Session 6 – Professor Bhambri**

**Topic: Competitive Dynamics (continued)**

*We will distill lessons of interdependence and competitive interaction from our discussion of RyanAir, Airbus/Boeing, and eBay/Amazon cases.*

**12:45 Lunch**

**13:45 Finance Session 3 – Professor Plotts**

**Topic: Performance Measurement and Forecasting Financial Performance**

*A critical component of valuation is the analysis of a company’s historical performance and benchmarking performance relative to peers. We will discuss key drivers of value creation including return on invested capital (ROIC), revenue growth and financial health.*

*We will analyze financial performance and how this will impact valuation and a firm’s strategic alternatives (including mergers and acquisitions). In this session we will review financial statement analysis techniques and will discuss how to apply the analysis for firm valuation and forecasting performance.*

**Required Readings:**

* Textbook: Titman Martin Chapters 2, 6.
* Review Themes 2-3 RWJ textbook Chapters 2-3 (Financial Statements and Cash Flow and Financial Statement Analysis)

**Learning Objectives:**

1. Gain proficiency in the evaluation of financial performance metrics.
2. To develop an understanding of basic ways to ‘slicing’ financial statement information to enhace decision-making and/or analysis.

*What do the numbers mean? We will discuss tools for analyzing company strategy and financial performance. We will focus on the following key areas:*

* **Cash Flow:** The difference between the amount of cash you end up with at the end of a certain period of time versus how much you started with. More positive cash flow is good. Cash is King! Decision-making rests on after-tax cash flows.
* **Ratios:** Learning what the numbers are really telling you. The financial statements tell a story through performance ratios such as profitability, leverage, liquidity, efficiency, return on investment.

**Discussion Questions:**

1. Consider the methods for measuring financial performance and assess either your own company or your Theme 8 project company on value creation and financial health. Calculate and analyze metrics such as return on assets, return on equity and return on invested capital. Consider the company’s capital structure, liquidity, leverage, efficiency, solvency, and other performance metrics.

**15:00 Break**

**15:15 Finance Session 4 – Professor Plotts**

**Topic: Frameworks for Valuation**

**Required Readings:**

* Case: Spyder Active Sports – 2004, HBS #9-206-027
* Textbook: Titman Martin Chapters 8-9**.** Skim/review Chapter 4 WACC/Cost of Capital (this was a theme 3 topic).

**Discussion Questions:**

1. Review the frameworks for Relative Valuation Using Market Comparables (Chapter 8) and DCF-Based Valuation and the Enterprise DCF valuation approach (Chapter 9).
2. Consider your own employer/company or Theme 8 project company. Which valuation technique is most relevant to the company given its stage in the business lifecycle, industry, etc.? Which valuation ratio would you use? Consider the appropriate comparable publicly traded companies that you would use to analyze the company.
3. Which key assumptions have the most impact on Enterprise DCF valuation: free cash flow forecast, terminal value, discount rate (WACC)? What, if anything, might be done to mitigate the risk or uncertainty in enterprise valuation?

**16:30 Break**

**16:45 Finance Session 5 – Professor Plotts**

**Topic: Frameworks for Valuation (continued)**

**Saturday, 19 September**

**07:30 Breakfast**

**08:30 Finance Session 6 – Professor Plotts**

**Topics: Application of Valuation Frameworks and Valuation in a Private Equity Setting**

**Required Reading:**

* Skim Titman Martin Chapter 10
* Read and Analyze HBS Case Study Spyder Active Sports – 2004 (9-206-027)

***Prepare the discussion questions in advance of the session (you may work in groups). This will represent 50% of your Theme 8A Finance score.***

*Please note that excel spreadsheets with financial data from the Spyder exhibits will be provided via e-mail.*

*The Spyder case allows us to assess an expansion/high-growth phase company’s strategic alternatives and an owner’s consideration of timing of “exit” options. We will discuss valuation issues of a privately owned company and aspects of entrepreneurial finance.*

*David Jacobs founded a high-end ski apparel company in 1978. He successfully built and grew the company, establishing a major international brand that appealed to ski racers and other active skiers. In 1995, he sought external financing to support further growth of the company and structured a financial deal with CHB Capital Partners, a private equity firm in Denver. By 2004, Jacobs was ready to consider alternative types of equity transactions that would provide a source of liquidity to him and his family, including sale of Spyder to another apparel company and sale of a large block of stock to a private equity firm.*

**Discussion Questions:**

1. Identify the different “exit” options that are feasible for Spyder in 2004, and analyze the benefits and costs of each alternative. Consider the interests and needs of the owner(s), the current state and future prospects of the company, and the current state of the financial markets.
2. Utilizing the forecast in exhibit 5 of the case perform a discounted cash flow valuation of Spyder. You will need to take the data from Spyder’s projected income statement (2005E-2008E) and calculate free cash flow = EBIT – taxes[[2]](#footnote-2) + depreciation – net working capital - capital expenditures = Spyder Free Cash Flow. You will need to estimate Spyder’s terminal value. The text mentions the growing perpetuity approach for stocks. If this method were to be applied for Spyder it would be assumed that at the end of 2008E the company reaches a steady state of growth. Another approach would be to simply value the company in 2008E based on its revenue or EBITDA and the multiples provided from exhibit 9 and 11. For example, if Spyder expects to have EBITDA of $27,895 in 2008, if the entire company were to be purchased for 10x EV/EBITDA then its implied value at the end of 2008 would be 278 million. This “terminal value” would need to be discounted back to present along with the forecast period cash flows. Like so much of what we do in finance, this approach is quite subjective and is highly dependent on assumptions for the company’s ability to achieve the forecast, market conditions, etc. The present value of the free cash flow forecast and the terminal value is your estimate for implied “Enterprise Value” of the company.
3. Spyder is not publicly traded; but we can still apply the market approach (price multiples) to estimate the company’s implied value. Evaluate the financial data provided for Spyder and also the comparable publicly-traded company price multiples (Exhibit 11) and comparable past merger and acquisition multiples (Exhibit 9) to determine an estimated “implied” value for the company in 2004.

This approach is similar to what you would have encountered in buying or selling a home. Look for comparable homes that have sold in your neighborhood, calculate a price per square foot based on the transaction and then apply to your own home to determine an implied price.

An example would be if you applied one of the EV/EBITDA multiples from a company or transaction to Spyder’s 2004 EBITDA, 10x $9,582 = implied value of $95 million in 2004. This approach is very subjective. Applying an appropriate multiple is dependent on the assumption that the asset you are comparing Spyder to is similar in growth, profitability, etc. The case does not provide descriptions of the merger and acquisition comparables. However, I have provided these descriptions in a tab in the excel workbook “Exhibit 9 Comp M&A description.” Descriptions of the public companies are provided in the exhibit 10 of the case. I have also provided some historical financial performance for these companies in the excel worksheet.

1. What are the risks to the valuation?
2. Compare the alternative transactions described on the last page of the case. Which one would you choose if you were: 1) David Jacobs; 2) a general partner in CHB Capital; 3) Shimokubo? Who else is affected by this choice?

**09:45 Break**

**10:00 Finance Session 7 – Professor Plotts**

**Topic: Spyder Case and Application of Valuation Frameworks (continued)**

**11:15 Break**

**11:30 Finance Session 8 – Professor Plotts**

**Topic:** **Valuation in a Private Equity Setting**

**Required Reading:**

* Titman Martin Chapter 10

**Discussion Questions:**

1. Given the discussion in Chapter 10 about Valuation in a Private Equity Setting, is Spyder is a good candidate for a leveraged buyout?
2. What are the major differences between a strategic and financial buyer and how would their views on valuation differ?

**12:45 Lunch**

**13:45 Strategy Session 7 – Professor Bhambri**

**Topic: Competing with Business Models and Platforms**

**Session Overview:**

*When Apple Inc. passed $600 billion in market valuation, it became the most valuable company in the history of the world. Yet, a little more than 15 years ago, Apple was on the verge of bankruptcy. What can we learn about strategy from a company whose turnaround has been described as the most remarkable story in business history? We will use the story of Apple to explore many topics that are central to strategy but focus especially on the creation of platforms and standards.*

**Required Readings:**

* Case: Apple, Inc. in 2012, HBS #9-712-490
* Article: How Companies Become Platform Leaders, A. Gawer and M. Cusumano, SMR 268

**Case Discussion Questions:**

1. What was the nature of competition in the personal computer industry in the late 1970s? in the mid-1980s? in the early 1990s? at the end of the case? What factors explain the dramatic changes?
2. Historically, what were Apple’s competitive advantages? Evaluate Apple’s strategies at different phases of its history.
3. How would you describe Apple’s strategy at the end of the case? What factors explain Apple’s resurgence? Is Apple’s success sustainable?
4. Can Apple continue its remarkable success without Steve Jobs? What strategic recommendations would you make to Tim Cook?

**15:00 Break**

**15:15 Special Session: GEMBA Forum**

**Distinguished Speakers:**

* Wang Yi, CEO of Liulishuo, a top mobile app in China (language learning app)
* Michael Jiang, VP of Dianping.com

**18:00 Joint pub session**

**Sunday, 20 September**

**07:30 Breakfast**

**08:30 Strategy Session 8 – Professor Bhambri**

**Topic: Competing with Incumbents**

**Required Readings:**

* Case: ASUSTeK and the Google Nexus 7 Tablet, HBS #9-613-056
* Article: “Lenovo: The rise of the frugal innovator”, Economist, May 24, 2014.

*This case illustrates platform competition in the tablet computer industry and highlights the challenges of modularity and specialization in complex technology settings. I would like you to apply the learning from the previous sessions to recommending a strategy for ASUSTeK?*

**Case Discussion Questions:**

1. If ASUSTek and Google want to design a tablet to compete with the Apple iPad, what challenges do they face?
2. Jerry talks about design, what is he trying to do?
3. How successful do you think Google will be in its vertical specialization model in competing with Apple? If you were Google, what would you do next?
4. How does a company like ASUSTek differentiate itself? What advice would you give Jerry?
5. Will Lenovo and Xiaomi succeed in smartphones? As global players?

**09:45 Break**

**10:00 Strategy Session 9 – Professor Bhambri**

**Topic: Competing with Incumbents (continued)**

**Required Readings:**

* Case: Tesla Motors, HBS #9-714-413
* Article: “Clean Technology in China: Red Light, Green Light”, Economist, March 8, 2014.
* Article: Why the Lean Start-Up Changes Everything, Steven Blank, HBR R1305C

**Session Overview:**

*When Tesla debuted its stock on NASDAQ in June 2010, it was the first initial public offering by an American automaker since Ford’s debut in 1956. Today, the stock is soaring at a price above $200 and Elon Musk, Tesla’s CEO, is a celebrity often called the “new Steve Jobs.” We will use the successes and challenges faced by Tesla to go deeper into the central task of a strategist, i.e., understand existing barriers to success and develop creative ways of surmounting them.*

**Discussion Questions**

1. What are the structural barriers that have prevented new entrants from succeeding in the automobile industry?
2. In what ways has Tesla overcome these barriers?
3. Do you think that Tesla has achieved a sustainable advantage that will enable it to succeed long term?
4. Will Tesla’s U.S. strategy translate successfully to China?
5. Would you recommend that Tesla be a niche company or a company with a broad product line attempting to serve multiple market segments?

**11:15 Break**

**11:30 Finance Session 9 – Professor Plotts**

**Topic: Creating Value Through Mergers and Acquisitions**

*Mergers and acquisitions (M&A) represent a popular strategy used by firms for many years, but the success of this strategy has been limited. In fact, research has shown that, on average, firms create little or no value by making acquisitions.*

*We know that the two main reasons for failed acquisitions are that 1) buyers overpay and 2) merger companies sometimes suffer from culture clash, or poor post acquisition integration and they fail to achieve expected synergies. During this session we will discuss mergers and acquisitions as a financial strategy. We will also discuss how companies consider the potential for synergies (revenue enhancement and cost advantages) in their analysis of strategic takeovers. We will identify M&A issues worth attention and develop an instinct for the problems and opportunities in an M&A situation. Finally, we end with a discussion of cross-border mergers and acquisitions, which have become prominent in recent years.*

**Required Readings:**

* “H.J. Heinz M&A,” David P. Stowell; Nicholas Kawar, HBS Product # KEL848-PDF-ENG

*During December 2012, Jorge Paulo Lemann, a co-founder and partner at 3G, proposed to Warren Buffett that 3G and Berkshire Hathaway acquire H. J. Heinz Company. Lemann and Buffett, who had known each other for years, jointly decided that the Heinz turnaround had been successful and that there was significant potential for continued global growth. 3G informed Heinz CEO William Johnson that it and Berkshire Hathaway were interested in jointly acquiring his company. Johnson then presented the investors’ offer of $70.00 per share of outstanding common stock to the Heinz board. After much discussion, the Heinz board and its advisors informed 3G that without better financial terms they would not continue to discuss the possibility of an acquisition. Two days later, 3G and Berkshire Hathaway returned with a revised proposal of $72.50 per share, for a total transaction value of $28 billion (including Heinz's outstanding debt). Following a forty-day “go-shop” period, Heinz, 3G, and Berkshire Hathaway agreed to sign the deal.*

* “Mergers and Acquisitions: Overcoming Pitfalls, Building Synergy and Creating Value,” HBS Product #: BH353-HCB-ENG Michael A Hitt; David King; Hema Krishnan; Marianna Makri; Mario Schijven; Katsuhiko Shimizu
* “Business Valuation in Mergers and Acquisitions” Product #: UV6759-PDF-ENG Michael J. Schill; Elena Loutskina
* Review the example in the Titman Martin textbook on pages 318-332 “Example: Immersion Chemical Corporation Acquires Genetic Research Corporation

**Discussion Questions:**

1. Perform a valuation of Heinz for this acquisition based on the financial information provided. Why did this transaction propose zero synergies? Discuss and quantify potential synergies that could be realized, including where they come from and the period of time over which they can be realized.
2. What are the specific factors that differentiate deals that are successful?
3. How would you modify your valuation performed for session 6?
4. Consider approaches to valuing both cost advantage and revenue enhancement synergies in a strategic acquisition. Consider synergies and/or benefits that might be difficult to quantify.
5. Identify important questions for the due diligence phase of an M&A transaction.

**12:45 Lunch**

**13:45 Project Workshop – Professors Bhambri and Plotts**

**Required Reading:**

* Theme 8 Project Assignment and previous student reports

*We have attached two student reports, one from GEMBA on Caterpillar/ERA and one from EMBA on ABInBev/Grupo Modelo. Review the reports in preparation for your project workshops. In your opinion, what do the reports do well? In your opinion, what are the report’s weaknesses? We will discuss the reports in greater depth during the team sessions tomorrow. In the meantime, use the reports as references for your own project planning in the group workshops*

**Discussion Questions:**

* All M&A transactions begin with the spark of an idea. Translating that idea into a concrete proposal takes hard work. Doing so teaches a lot about the drivers of M&A success, and the elements of deal design. Designing a transaction requires skills of analysis and negotiation. During the Theme 8 project your team will survey a number of analytical tools and will complete strategic frameworks in your analysis of a current or proposed cross-border M&A transaction. The work in this project will teach you a great deal about the design process, and the important leadership skills called for. We will survey some strategic frameworks useful in M&A, and the steps necessary to translate a concept into a solid proposal. Form an initial opinion about your Theme 8 project deal. The key aim is to develop your ability to think critically and to form a “view” of events and circumstances.

**15:00 Break**

**15:15 Project Workshop Continued – Professors Bhambri and Plotts**

**Monday, 21 September**

**07:30 Breakfast**

**08:30 Theme 8A Finance Quiz**

**09:45 Break**

**10:00 Finance Session 10 – Professor Plotts**

**Topic: Creating Value Through Mergers & Acquisitions *continued***

**11:00 Q&A, Summary –** **Professor Plotts**

**11:15 Break**

**11:30 Strategy Session 10 – Professor Bhambri**

**Topic: Strategy Development and Execution**

**Required Readings:**

* Case: Haier: Taking A Chinese Company Global in 2011, HBS #9-712-408
* Article: “Haier and Higher” Economist, October 12, 2013.

**Case Discussion Questions:**

1. What were the key decisions that led to Haier’s success?
2. Try to distill an underlying logic and pattern to the types of decisions and the sequence in which they were made.
3. What do you see as the most significant challenges facing Haier at the end of the case?

**12:45 Lunch**

**13:45 Q&A, Summary and Evaluations – Professor Bhambri**

1. Participants may be asked to complete a brief, free registration to access the McKinsey & Company Insights and Publications. [↑](#footnote-ref-1)
2. Tax rate if determined from the income statement ranges from 16% to 45%. It is acceptable to consider a constant corporate tax rate (i.e. 35%)? Tax rate details were not given or discussed, and since Spyder has international operations and those foreign tax rates weren't mentioned, it is acceptable to assume an average tax rate based on the data provided or a corporate tax rate assumption. [↑](#footnote-ref-2)