# Introduction

## Synopsis

## Problem Statement

How to sustain growth

## Ethical Factors

## Company’s strategy

# External Analysis

## Industry Structure & Trends

Main players:

* CPAs
* Branded Tax preparers (H&R, Jackson Hewitt, Liberty Tax)
* Non-branded 50,000 mom&pop shops

Block: 16.3M clients, competitors: 3M clients

CPAs + Small offices: 53M clients

PC based market:

* Block 30%; revenues $88M, margins 10%
* Inuit: 70%; revenues $487M, margins 23.7%

IRS expects growth in # returns filled by 1-3% annually

425 changes per year to tax code, requires training & changes to software

Compentation for professional services making up larges cost in the industry

Clear demand for RAL

## Industry Economics

* 130M individuals file tax in US in 2003; majority filled during Q1, 77% eligible for a refund
* 1-3% annual growth in # returns filled
* 13b$ industry, 9.4B$ from CPA & unbranded offices
* Main sources of revenues from 2 channels: Tax preparation fees & RALs fees
* EFS market size (actual): 4-500M$; 100$/customer or 5% average refund, but per client AFS fee estimated at 1k$/client therefore a 4-5B$ market potential.

## Key Success Factors

* Education: keep up with IRS annual changes to tax code

## Competitive Situation

## Ethical Factors

# Internal Analysis

## Strategy

* Product diversification via M&A rather than internal development
* Following a strategy of differentiation by offering financial advice in addition to tax services (Block advantage). Set goal “Enhance client experience through consistent delivery of valuable services and advice”

## Financial Analysis

* Largest business segment: Option One Mortgage services

[financial health of various business divisions]

* Block revenues from tax operations: 2.1B$; increase of 13% while # customers down by 3%
* ARPU from company owned offices: 149$
* RAL 2004 nrevenues: 168M$, up from 139M$ in 2003; pre-tax margins of 28.7%
* Spending annually 115M$ in marketing to replace 5M departing clients; cost of replacement 23$/client
* Cost of incremental clients: 130$, estimated to grow at CAGR 20-25%. With annual ARPU of 149$, not sustainable
* ATMs used to clear checks with ACE partnerships are losing 28k$/year (see Exhibit B). Would need to double revenues from check clearing to make this a break even operation [Market size of check clearing missing]

Product Mix

* US Tax and Mortgage services contribute to the largest share of revenues, and present consistent growth, whereas Corporate Operations and Investment Services are generating losses and are on a downtrend.
* US Tax and Mortgage services also generate the largest return on assets:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **2003 numbers** | **Revenue** | **Identifiable Assets** | **% Total Assets** | **ROA** |
| US Tax | $547 | $281 | 6.1% | 195% |
| Mortgage | $694 | $1,157 | 25.1% | 60% |
| Business Services | -$14 | $675 | 14.7% | -2% |
| Investment Services | -$128 | $1,489 | 32.4% | -9% |
| International Tax Operations | $10 | $33 | 0.7% | 30% |
| Corporate Operations | -$122 | $967 | 21.0% | -13% |

* Furthermore, 68% of total assets are used up in operations that are generating losses: business services, investment services and corporate operations
* Divesting from these non-profitable operations could free up 3.1B$ of capital which could be re-invested in expanding core products

## Main Issue

* Although slightly profitable, education program is used to train the entire industry; effectively saving training costs to competition (reinforced by Hewitt created from former H&R employee; now becoming a major threat by stealing customers)
* 68% of Assets are used up in operations that are generating losses and not aligned with H&R Block’s core competencies

## Ethics

* Stop educating non-Block employees? Detriment to the overall quality of service in the industry

## Operations

* New senior management team, mostly recruited from Amex; a lending institution
* Employs 12,000 people; 7500 in tax division, 118,000 seasonal tax professionals
* Product mix expansion developed via M&A activities:
  + Mortgage lending division after acquisition of Assurance Mortgage Company
  + Discount Brokage from acquisition of Olde Financial Corporation
  + Business Service from RSA McGladrey
  + => should look for acquisition targets
* Already have 18.7M clients; 58% of 16.3M clients in retail offices earning less than 30k$/year
* RAL delivers funds to 4.6M customers
* Partenered with Benificial Bank in ’87 to start offering RALs
* Opening locations in 550 Walmarts; consistent with competing on price because of WM’s demographic, but inconsistent with differenciation strategy and spending on marketing/brandind
* Partenered with ACE for ATM like cash checking machines; tensions growing with ACE

EFS

## Internal Value Chain Effectiveness

## Main Issue

* 5M clients leaving Block each year; 50% US population already been a customer =>
* Perception of predatorial lending (settled lawsuite for 43.5M$ in 2003)
* Tensions with ACE

## Marketing & Competitive Position

* Although # tax returns filed is growing, Block’s # customers is decreasing. Due to the low income majority of Block’s customers who are susceptible to unemployment
* During the same period, # customers of major competitors is growing. They are focusing on price (offering free filing for 1st time)
* High Brand recognition with 98% Americans, but 5M clients leave every year
* After introduction of RALs, customer demographic shift towards lower income segment
* 2004, 4.3M clients purchase RALs for average 3k$ refund (1.5M instant RALs, 2.8M traditional)
* As a n industry leader, H&R Block has social responsibility

# Alternatives

Strategy:

* Maintain marketing focus on brand or move towards low cost strategy?
* If going to low cost, fpcus on anciliary services or invest in web platform (purchase Inuit)?

Operations:

* Divest from down trending non-profitable operations (business services, investment services and corporate operations)?
* Stop offering educational services to competition to strengthen competitive edge?

Risk:

With industry shifts towards price driven decision making, the H&R Block runs the risk of losing brand appeal to it’s franchisees since brand perception added value will decrease

# Recommendation

# Implementation

Exhibit A: H&R Block’s Cost of Capital

Data taken from 2003 financial statements, all numbers in M$

Annual Dividend Growth:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Year** | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** |
| Dividend | 84 | 95 | 105 | 108 | 115 | 125 |
| Growth |  | 13% | 11% | 3% | 6% | 9% |

Average Dividend Growth: 8%

Cost of Equity:

|  |  |
| --- | --- |
| Dividend Payment | $125 |
| Market Cap | $6,936 |
| Return | 2% |
| Growth | 8% |
| Cost of Equity | 9.8% |

Cost of debt:

|  |  |
| --- | --- |
| Interest Payment | $92.6 |
| Long Term Debt | $822.3 |
| Cost of debt | 11.3% |

WACC

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Liabilities** | **SH Equity** | **Total** |
| Quantity | $2,940 | $1,664 | $4,604 |
| % of total Assets | 64% | 36% | 100.0% |
| Cost | 11.3% | 9.8% | 21.1% |
| Weighted Cost | 7.2% | 3.5% | 10.7% |

Exhibit B: Profitability of ATMs

|  |  |  |
| --- | --- | --- |
| **Revenues** | |  |
|  | # ATMs | 200 |
|  | # checks cashed | 110000 |
|  | Total Value of checks | $220,000,000 |
|  | revenues from 3% comission | $6,600,000 |
|  | **Average revenue/ATM** | **$33,000** |
|  |  |  |
| **Costs** | |  |
|  | Annual maintenance | $35,000 |
|  | Depreciation (15k$CAPEX/5y) | $3,000 |
|  | Cost of working capital (220k$@10.7%) | $23,540 |
|  | **Total cost/ATM** | **$61,540** |
|  |  |  |
| **P/L** |  | **-$28,540** |