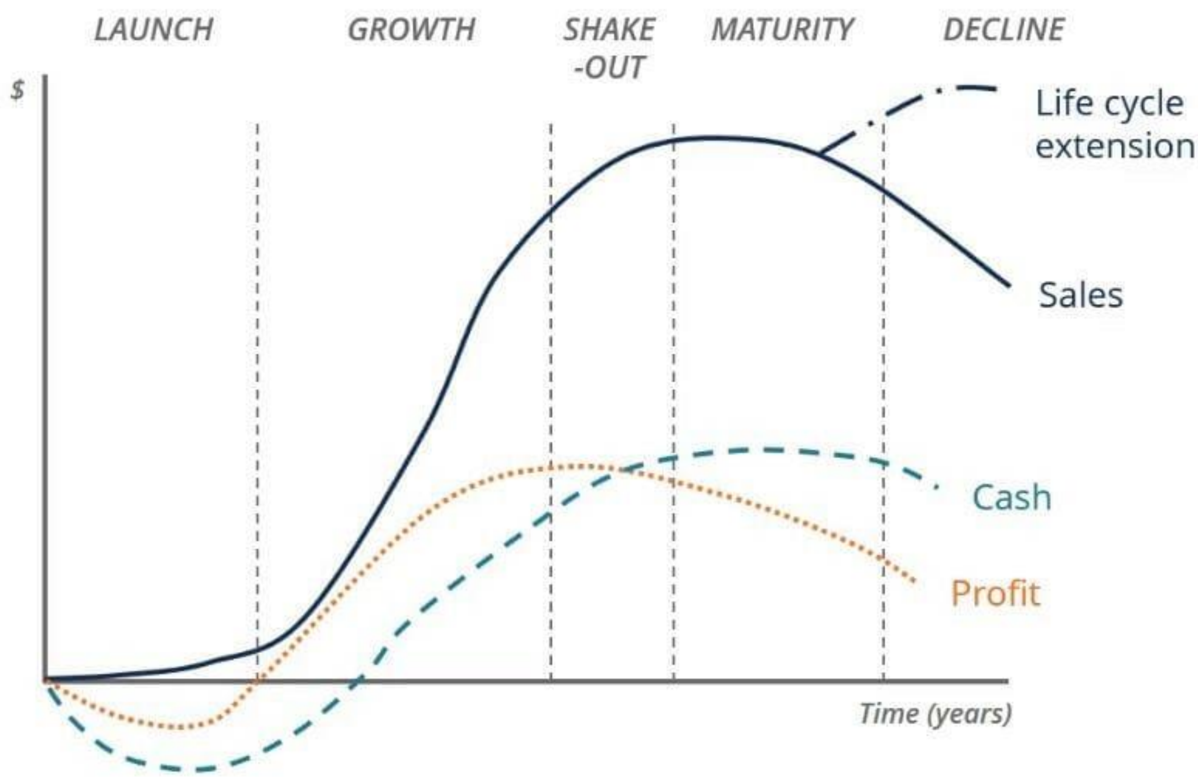
Department of Finance Dr. Bousbaa Hana
Faculty of Economics, Commerce & Management Financial Strategy module
Badji Mokhtar Annaba University

Part 03: lecture 01

1/ What is the Business Life Cycle?

The business life cycle is the progression of a business in phases over time and is most commonly divided into five stages: launch, growth, shake-out, maturity, and decline. The cycle is shown on a graph with the horizontal axis as time and the vertical axis as dollars or various financial metrics. we will use three financial metrics to describe the status of each business life cycle phase, including sales, profit, and cash flow.



Phase One: Launch

Each company begins its operations as a business and usually by launching new products or services. During the launch phase, sales are low but slowly increasing. Businesses focus on marketing to their target consumer segments by advertising their comparative advantages and value propositions. However, as revenue is low and initial startup costs are high.

In fact, throughout the entire business life cycle, the profit cycle lags behind the sales cycle .

Finally, the cash flow is also negative but dips even lower than the profit. This is due to the capitalization of initial startup .

Phase Two: Growth

In the growth phase, companies experience rapid sales growth.

However, as the profit cycle still lags behind the sales cycle, the profit level is not as high as sales. Finally, the cash flow during the growth phase becomes positive, representing an excess cash inflow.

Phase Three: Shake-out

During the shake-out phase, sales continue to increase, but at a slower rate, usually due to either approaching market saturation or the entry of new competitors in the market. Sales peak during the shake-out phase. Although sales continue to increase, profit starts to decrease in the shake-out phase. This growth in sales and decline in profit represents a significant increase in costs. Lastly, cash flow increases and exceeds profit.

Phase Four: Maturity

When the business matures, sales begin to decrease slowly. Profit margins get thinner, while cash flow stays relatively stagnant. As firms approach maturity, major capital spending is largely behind the business, and therefore cash generation is higher than the profit on the income statement.

However, it's important to note that many businesses extend their business life cycle during this phase by reinventing themselves and investing in new technologies and emerging markets.

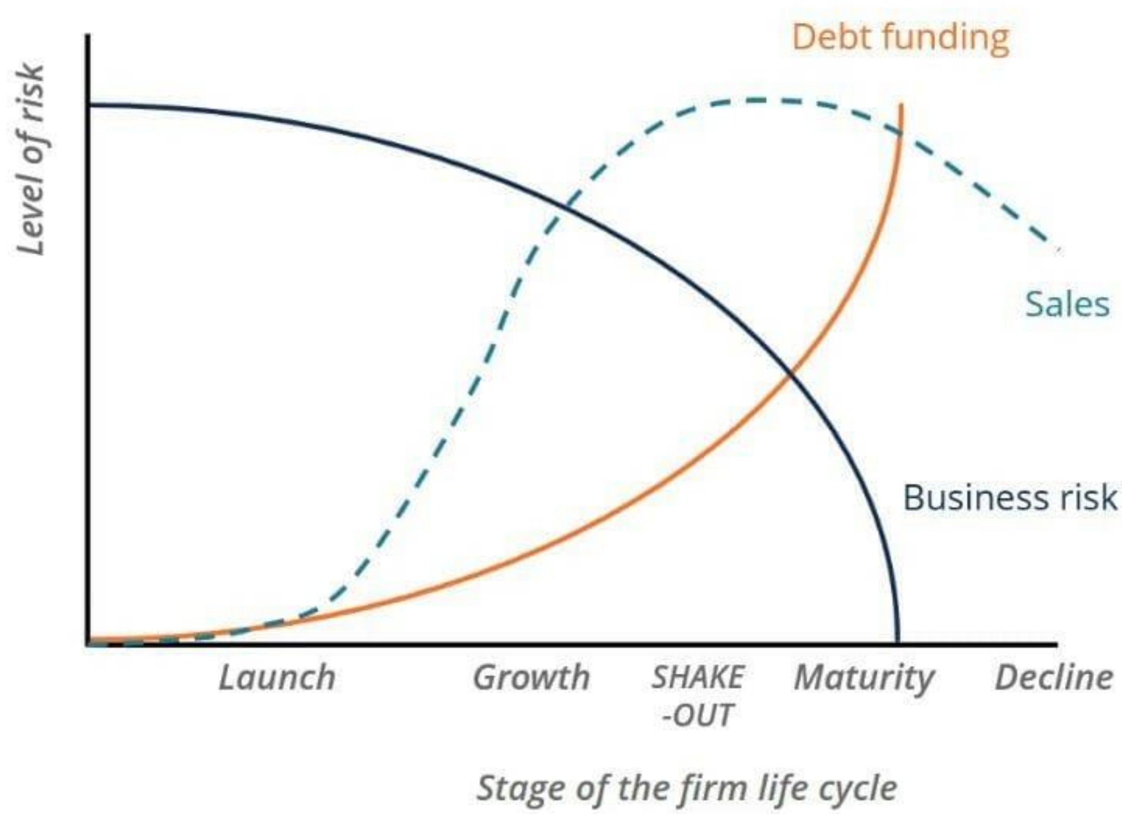
Phase Five: Decline

In the final stage of the business life cycle, sales, profit, and cash flow all decline. During this phase, companies accept their failure to extend their business life cycle by adapting to the changing business environment. Firms lose their competitive advantage and finally exit the market.

2/ Corporate Funding Life Cycle

In the funding life cycle, the five stages remain the same but are placed on the horizontal axis. Across the vertical axis is the level of risk in the business; this includes the level of risk of lending money or providing capital to the business.

While the business life cycle contains sales, profit, and cash as financial metrics, the funding life cycle consists of sales, business risk, and debt funding as key financial indicators. The business risk cycle is inverse to the sales and debt funding cycle.



.

Phase One: Launch

At launch, when sales are the lowest, business risk is the highest. During this phase, it is impossible for a company to finance debt due to its unproven business model and uncertain ability to repay debt. As sales begin to increase slowly, the corporations' ability to finance debt also increases.

Phase Two: Growth

As companies experience booming sales growth, business risks decrease, while their ability to raise debt increases. During the growth phase, companies start seeing a profit and positive cash flow, which evidences their ability to repay debt.

The corporations' products or services have been proven to provide value in the marketplace. Companies at the growth stage seek more and more capital as they wish to expand their market reach and diversify their businesses.

Phase Three: Shake-out

During the shake-out phase, sales peak. The industry experiences steep growth, leading to fierce competition in the marketplace. However, as sales peak, the debt financing life cycle increases exponentially. Companies prove their successful positioning in the market, exhibiting their ability to repay debt. Business risk continues to decline.

Phase Four: Maturity

As corporations approach maturity, sales start to decline. However, unlike the earlier stages where the business risk cycle was inverse to the sales cycle, business risk moves in correlation with sales to the point where it carries no business risk. Due to the elimination of business risk, the most mature and stable businesses have the easiest access to debt capital.

Phase Five: Decline

In the final stage of the funding life cycle, sales begin to decline at an accelerating rate. This decline in sales portrays the companies' inability to adapt to changing business environments and extend their life cycles.