

# Executive Briefing

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## A tale of two companies: Meteoric rises and staggering falls

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FROM IESE INSIGHT

How can a company's shares see a two-year profit of 310 percent and then lose it in just over a year? What could possibly destroy the share value of a company that seemed all but invincible to its investors a few months before? These and other questions are answered by Pablo Fernández, professor of Financial Management and head of the PricewaterhouseCoopers chair of Corporate Finance at IESE, in his article "Descensos memorables en las cotizaciones: Telepizza y Boston Chicken" ("Memorable Cases of Plummeting Stocks: Telepizza and Boston Chicken"), where he analyzes two extreme cases of major stock market rises by companies that ended up suffering dizzying descents in their respective stock exchanges, both brought on by disproportionate growth expectations.

Boston Chicken, a chain of over 1.700 restaurants specialized in family-style meals with locations across the United States, and Telepizza, the leading Spanish pizza chain with over 700 establishments, both enjoyed a period of high profits and value creation for its stock. What followed were negative profits and the erasing of their recently gained value. The similar performance by the two, says the author, was a result of disproportionate growth expectations for future cash flows, which favored growth but were ultimately adjusted down, causing both disasters.

The American chain Boston Chicken blessed its shareholders with a growth of 1.470 billion dollars from November 1993 to December 1996. This equated to a 310 percent profit. Shortly thereafter, in October 1998, the company opted for bankruptcy protection. The value destruction amounted to 3.293 billion dollars, translating into a -100 percent profitability for investors.

Telepizza underwent a growth pattern similar to that of Boston Chicken, but with far greater profitability. From November 1996 to June 1998, the value created was 1.936 billion dollars, with 1.338 percent profitability. The value destroyed, from 1998 to October 1999 was more moderate, resulting in a profitability of -55 percent and 1.543 billion dollars of value destruction.

### More Order, Less Risk

Something that jumps out when analyzing the history of the two companies is that the declining profits followed disparate parameters, despite their similar growth patterns.

The initial growth in the case of Boston Chicken, aided by the inflated expectations deriving from the companies' early business performance, the possible acquisitions and the advent of new businesses, forced the company to take on a major risk to finance its growth, which in the end it was unable to control.

Fernández feels that this was a determining factor in the sudden collapse of the business. Boston Chicken assured its rapid expansion by financing a number of "financed area developers" (FADs), which were like franchises but fronted just 20 percent of the investment. The rest was provided by the parent company in the form of loans, whose profitability was not included in the company's accounting statements.

It saw negative profits and ultimately lost 156.6 million dollars in 1996. Thus, the debt

continued to rise while the company financed investment in franchises by issuing shares and debt, and treating the interest as profits.

Telepizza's growth was much more orderly: the company assumed less financial risk and did a better job of controlling the operating risk than its American counterpart.

The Boston Chicken situation was one of excessive disarray for its investors, who were mistaken about the scope of the operations and unable to see that the company, in addition to selling food, was acting as a financial entity, and could not make its restaurants profitable. It could not accurately interpret its accounting information or carry out a less aggressive plan for expansion.

### **Aggressive Expansion**

Prof. Fernández breaks down the similarities between the American company and Telepizza, which revolve primarily around an aggressive expansion strategy. Whereas for Boston Chicken this meant having a presence throughout the United States via franchises, the Spanish chain decided to diversify its business and to try out foreign markets.

Thanks to their expansion strategies, both companies witnessed an impressive growth in sales and number of establishments. Through self-owned and franchise locations, they launched complementary businesses, increased their product offerings and started an aggressive price war backed up by strong marketing campaigns.

Telepizza, however, did not run into franchising problems, but rather market saturation around 1999, preventing it from sustaining the previously established growth rate. As a result, share prices dropped and the owner opted out of the company.

Boston Chicken and Telepizza both saw their golden era in the stock market cut short, due to the negative profitability of their shares and value destruction, stemming from the downscaling of their disproportionate expectations for growth and expansion, which had caused them to skyrocket in the stock markets and which ultimately caused them to nosedive.

*By Pablo Fernández*

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**Source:** [IESE Insight](#)

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