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International financial management: A look at Amazon Inc.

Introduction

The success of any business operation is subject to many externalities, which prompt organisational executives and financial managers to engage in strategic thinking looking into the future. Essentially, the primary objective of several multinational corporations (MNCs) is to keep growing while increasing the shareholders' wealth (Cui et al. 2017). Therefore, how a business enterprise performs locally, regionally, and globally is influenced by the management's financial strategies and structures (Madura 2022). Some grey areas that entrepreneurs have given a lot of attention include dividends policies, shareholders' worth, cash flows, capital investments as a means for long-term growth, debt management, and liquidity factors (Haryanto et al. 2021; Ismail 2017). Based on that, this paper explores Amazon Inc.'s dividend policy, the efficient market hypothesis (EMH), and projects appraisal strategies employed by the company.

With a long growth runway and strong cash flows in recent years, Amazon Inc has had significant investment and is now focusing on the future. It is important to note that Amazon does not pay dividends to its shareholders and does not have a plan to pay the same any time soon. The company's operational model is a pure capital appreciation model. While some shareholders focusing on income-generating equities have always wanted to have dividends declared by the company, the growth investors argue that dividends yield has a likelihood of being low. Therefore, they prefer to have the cash flows put into other use, for instance,

growth capital projects or acquisition ventures (Weber 2021). The chart below explains the reason why Amazon does not emphasise dividend payout.

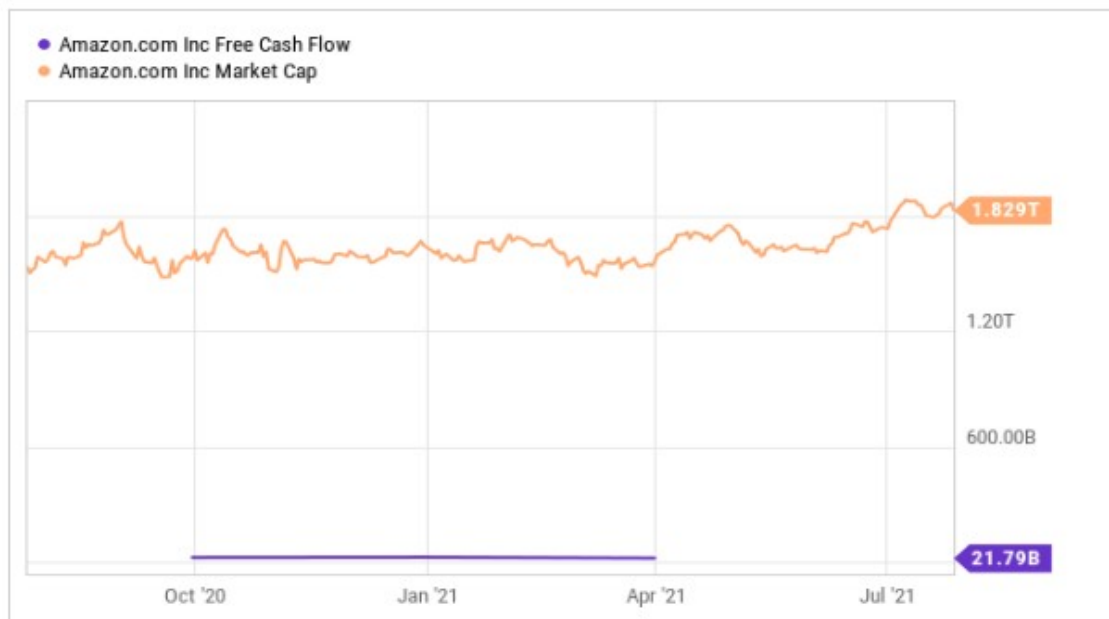


Fig. 1: Market capitalisation and free cash flow for Amazon Inc. in 2021 (Weber. 2021)

From the graph above, Amazon Inc. traded at more than eightytimes the free cash flow (an average market cap of \$1.6T against a cash flow of \$21.79B) in the last quarter of 2020 and the first quarter of 2021 (CompaniesMarket.com2022; Weber 2021). At this point, the free cash flow yield levels at approximately 1.2 percent. If50 percent of the cash flows were to be paidin the form of dividends, then the dividend yield would drop to 0.6 percent. Such a small percentage yield is not likely to lure many income investors to Amazon Inc.'s stock. More so, it does not positively influence the company's total returns. Despite the fact a dividend would lead to a paltry yield of about 0.6 percent, it would gobble billions of USD in cash, denying the firm cash for future capital investments.

The core operations at Amazon are not driven by high margins but the capability of the company to expand its business by investing in more high-value ventures, for example, cloud computing (CBInsights 2022). With such capital investments on the horizon, the firm is not likely to achieve it if it pays dividends worth billions of USD in a year. Thus, the company's

management is always strategising on developing ways to invest the cash profitably because that is the better option for creating shareholder value. At some point, Amazon is likely to indulge in dividend payments once it matures at some juncture; this is similar to Apple's case, where the company was forced to start paying dividends after its cash flows grew exponentially to a point where a profitable re-investment of the same would not suffice.

The efficient market theory (hypothesis) hypothesises that share prices are a reflection of all requisite information and that generating a consistent *alpha* (abnormal rate or excess return on investment) is not possible (Downey and Scott, 2021). As per the EMH theory, trading of stocks is conducted at values that are said to be fair, so it is not possible for buyers to purchase undervalued stocks or offload them at a price that is inflated. Neither market timing nor expert stock selection can beat the overall market. The only option an investor can generate a consistent *alpha* is by buying riskier investments.

The EMH can be well understood by comparing Amazon Inc. with another notable entity, for instance, Berkshire Hathaway. About five years ago, the two companies had the following financial metrics;

Table 1: Financial metrics for Amazon and Berkshire Hathaway between 2011 and 2015

	Market Cap	Profit/loss 2015	Profit/loss 2014	Profit/loss 2013	Profit/loss 2012	Profit/loss 2011	P/E ratio	Annual growth rate
Amazon Inc.	\$356B	\$0.59B profit	\$0.24B loss	\$0.274B profit	\$0.03B loss	\$0.63B profit	306	49.4%
Berkshire Hathaway	\$356B	\$24.08B profit	\$19.87B profit	\$19.47B profit	\$14.82B profit	\$10.25B profit	14.5	13%

From the data above, Amazon Inc.'s profits and losses were consistently below \$1 billion, while Berkshire earned increasing profits in tens of billions of USD over the same period. This comparison is well shown using the graph below.

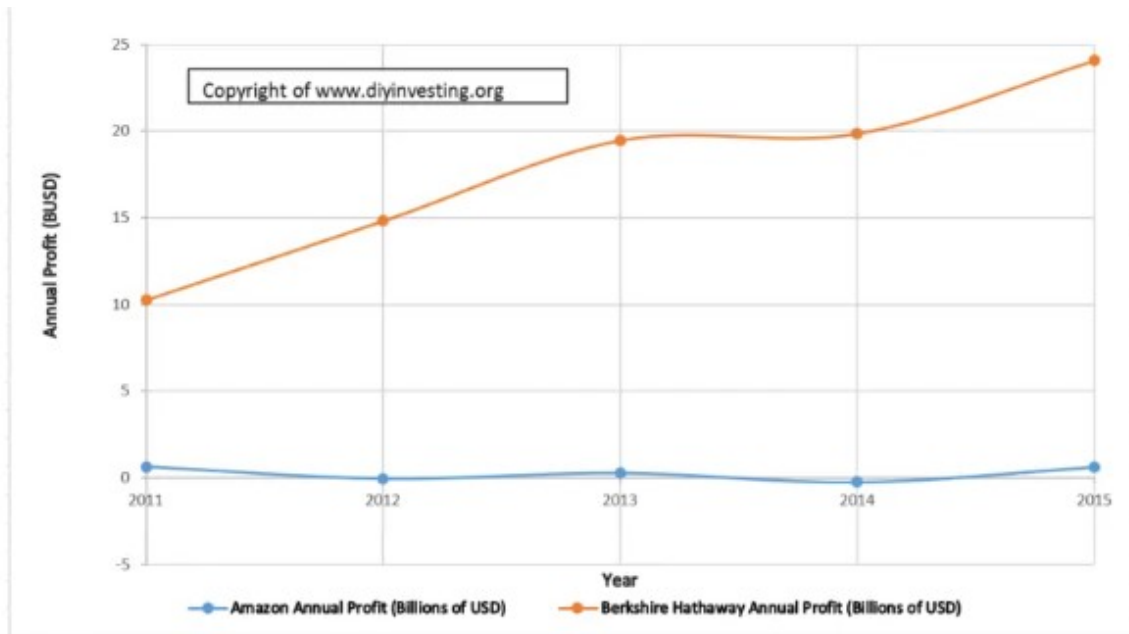


Fig. 2: Comparison of Amazon Inc. and Berkshire Hathaway profits (Henninger, 2016)

The graph above shows a big discrepancy in regard to the profits earned by the two companies though Berkshire Hathaway is a conglomerate with various sources of income; about fifty operating firms then. On the other hand, Amazon Inc. had fewer sources of revenue. Apparently, the market shows that the two firms had the same worth at this particular point. According to EMH, an individual investing \$5,000 in Amazon and another investing the same amount in Berkshire would have the same stock performance; the firm's market value depends on future performance rather than its past. If the profit performance of the two companies were to hold for the next five years ending 2020, then the profits would be as shown on the chart below.

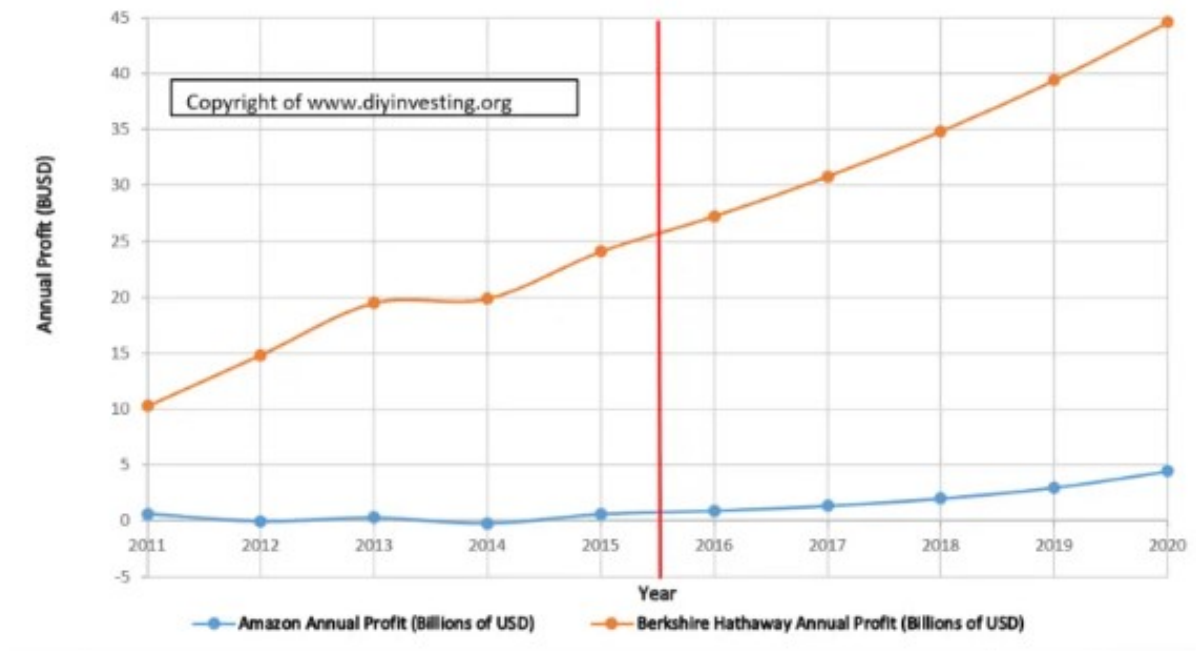


Fig. 3: Assuming the EMH holds, the investor's performance remains constant whether Amazon Inc. or Berkshire Hathaway has been selected (Henninger, 2016)

According to the projections above, Amazon would earn a profit worth \$4.4B in 2020, whereas Berkshire would end up with an annual profit of \$44.5B at the same time. Assuming that both companies end the same period with a fair value of a P/E ratio of 15, Amazon Inc.'s value would be \$66B, while Berkshire Hathaway's value would be \$667.5B in 2020. Considering that, if an individual puts \$5,000 in Amazon and another invests a similar amount in Berkshire, then a large disparity would be observed. The Berkshire Hathaway investor would earn almost ten times more than what the Amazon investor would have made. However, this outcome would not be possible, as suggested by EMH. Based on the analysis above, it is evident that an investor can beat the market through good stock selection by conducting a comprehensive market analysis. Since market dynamics allow various businesses to grow differently and using the data provided, it is apparent that Amazon will likely maintain a higher growth rate than Berkshire in the following five years or more. Amazon earnings would eventually surpass what Berkshire is posting, a possible outcome. As such, the market valuation of Amazon and Berkshire Hathaway would be considered

efficient. Investors that believe the EMH to be true can invest purely in stocks (bonds or index funds) that match the market. Investing under EMH conditions allows investors to earn maximum returns that are risk-adjusted. Investors that do not believe in EMH operate under unclear circumstances, albeit they can invest in index funds. Average market returns can still be captured under these circumstances.

An e-commerce giant that pegs its success on highly efficient operational management, Amazon Inc. was established about three decades ago from a small start-up. Built by a hedge fund executive in 1994, the start-up was committed to selling books online after thorough research. Despite the presence of other online merchants like Computer Literacy doing the same business, Amazon's model of doing business was unique, delivering any book to the readers anywhere (Hall, 2022). Though the company began as a bookseller, the founder contended from the beginning that the online company was a technology venture meant to simply online buying and selling. There was some skepticism from some financial analysts and journalists given the rivalry from renowned bookselling chains, for example, Borders and Barnes. This was supported by the company's lack of profit(s) for about seven years (to the end of 2001).

With the help of net present value (NPV), Amazon has been considering feasible projects with positive NPV since maximisation of shareholder wealth is guaranteed. Therefore, the firm has gone through an aggressive expansion strategy providing a platform for other associates (websites) to offer their merchandise, which includes other consumer goods other than books (Ferguson, 2017). To ensure sustainable growth in its operations, the company needed to digress from private investors; therefore, it became a public entity and raised more than \$50 million on the NASDAQ market. The company also leveraged its impressive stock to fund its aggressive expansion and acquisition growth strategy (Hall, 2022). Amazon's cash flows have remained an essential component of its operations since

they determine the profitability index. Through careful selection of market opportunities, the company has been able to undertake capital-intensive projects that have positive present value cash inflow compared to the initial cost. Amazon Inc. remains one of the largest commercial enterprises in the world, with a market capitalisation of about \$1.8T and a share price index of \$2,921 (CompaniesMarket.com, 2022).

Conclusion

Multinational corporations (MNCs) such as Amazon are guided by international financial management theories, which elaborate on fundamental elements that affect the financial performance of companies engaged in international business. Amazon does not engage in dividend payments because of its quest to continue expanding through capital investments. Theories such as the efficient market hypothesis help investors select performing stocks based on financial operations and market yields over time. The NPV and profitability index are some of the project's appraisal strategies incorporated by the company to increase the shareholder's wealth.

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