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OGL 260: Resource Allocation in Org
Unit #5
Topic: Tesla

A project that would otherwise be rejected is an electric car. The last American car startup called Ford was founded over one hundred years ago. Barely a decade old, at their factory in Fremont, California, Tesla Motors builds highly technical, high-performance sport cars that happen to be electric. “The company was founded in 2003 by a group of engineers in Silicon Valley who wanted to prove that electric cars could be better than gasoline-powered cars. With instant torque, incredible power, and zero emissions, Tesla’s products would be cars without compromise. Each new generation would be increasingly affordable, helping the company work towards its mission: to accelerate the world’s transition to sustainable transport.” (Tesla Motors, 2015)

“Tesla’s engineers first designed a powertrain for a sports car built around an AC induction motor, patented in 1888 by Nikola Tesla, the inventor who inspired the company’s name. The resulting Tesla Roadster was launched in 2008. “The Roadster accelerated from 0 to 60 mph in 3.7 seconds; achieving a range of 245 miles per charge of its lithium ion battery, which set a new standard for electric mobility. Tesla would sell more than 2,400 Roadsters and is now on the road in more than 30 countries.” (Tesla Motors, 2015)

“In 2012, Tesla launched the Model S, the world’s first premium electric sedan. The car was built from the ground up to be 100 percent electric and redefined the very concept of a four-door car. There is room for seven passengers and provides the comfort and utility of a family sedan while achieving the acceleration of a sports car accelerating from 0 to 60 mph in about five seconds. The Model S was named Motor Trend’s 2013 Car of the Year and achieved a 5-star safety rating from the U.S. National Highway Traffic Safety Administration.” (Tesla Motors, 2015)

In late 2014, “Tesla CEO Elon Musk unveiled two dual motor all-wheel drive configurations of the Model S that further improve the vehicle’s handling and performance. The 85D features a high efficiency motor at the front and rear, giving the car unparalleled control of traction in all conditions. The P85D pairs a high efficiency front motor with a performance rear motor for supercar acceleration, achieving a 0 to 60 mph time of 3.2 seconds – the fastest four-door production car ever made.” (Tesla Motors, 2015)

According to Kneown, “options or flexibility can make it worthwhile to pursue projects that would otherwise be rejected, or make projects undertaken more valuable.” (Kneown, p. 369). Kneown explains “three of the most common types of options that can add value to a capital-budgeting project which include: (1) the option to delay a project until future cash flows are more favorable, which is considered most common for firms with an exclusive right, such as a patent to a product or technology. (2) the option to expand a project, perhaps in size or introduce new products that would not have otherwise been feasible, and (3) the option to abandon a project if its future cash flows fall short of expectations.” (Kneown, p. 361) “Capital budgeting, a project’s risk must be assessed on three levels – those risks include project stand-alone risk, contribution-to-firm risk, and systematic risk.” (Kneown, p. 362) According to Kneown, “the first two risks are an inappropriate measure of the meaningful level of risk of a capital-budgeting project.” Thus, systematic risk is the most appropriate risk measure for capital-budgeting because it affects shareholders.

According to Forbes, during the third quarter of 2014 earnings report, Tesla Motors had a reasonable expectation that their share price would drop. Tesla announced the launch of two new car models. As a result, “shares of Tesla (TSLA) moved higher leading up to the event, but dropped sharply lower thereafter. That’s not because the new models announced were bad, to the contrary. The models were better than hoped for by some enthusiasts, but the cars add complexity to the company’s business model. Investors need to estimate the production cost of these cars, the profitability of their pricing and the estimated length of their production schedule. The new announcement asked investors to have more faith in the company’s plans,

not less.” (Gordon Scott, 2014). As we all know, investors don’t like uncertainty. “Tesla’s stock dropped 10% in the two trading sessions following the launch. It follows that there is a substantial degree of risk that the upcoming earnings announcement won’t bring more clarity to estimating the value of the company.” (Gordon Scott, 2014).

With regards to this example, both Contribution-to-firm risk and systematic risk play an integral role. I can only assume that Tesla evaluated the amount of risk that the addition of the two new car models would contribute to the firm as whole; taking into consideration some of the project risk would be diversified away with Tesla’s other projects and assets. In addition, I presume Tesla also evaluated systematic risk taking into account both risk diversification taking into account the other project’s and by shareholder’s as they combine TSLA with other stocks in their portfolio’s. (Kneown, p. 370)

Since the launch of the two new car models, Tesla’s estimated stock price was ~\$240 per share and has continued to drop. On the surface and without further research, it appears that Tesla’s stock hasn’t recovered since the launch announcement; closing on February 24, 2015 at ~\$204.

In my opinion, I would not have postponed the launch. As previously stated, “The models were better than hoped” Although the cars added complexity to the company’s business model, investors needing to estimate the production cost, the profitability pricing and the estimated length of their production schedule – in my opinion, the demand for electric cars over gasoline powered cars will increase over the next 5-10 years (if not sooner). This is my opinion because as we continue to become an environmentally conscious society, gasoline powered internal combustion engines will be take a backseat to the eco-friendly electric car. Also, as we become a more independent nation, we will no longer need to be dependent on oil imported from foreign countries.

Tesla is not just an automaker, but also a technology and design company with a focus on energy innovation. Innovative electric powertrain technologies that are unencumbered with

legacy investments in the internal combustion engine will lead the next technological era of the automotive industry. (Scott, 2014)

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