Introduction of bringing down the cost of

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Introduction

It is without doubt that the global financial crisis rattled the financial positions of most firms all over the world. This report studies the effects of the global financial crisis on Westfarmers Ltd, a listed Australian company.

Using a pre and post GFC approach, a critical analysis of the company's financial ratios between the years 2007 to 2010 sheds more light on the effect the GFC had on this particular firm (Maslow, 2000). The company's financial statements over the years also provide more insight of the financial health of the firm. The global financial crisis hit the world in 2008 and consequently posed many questions over the viability of corporations across the world. A lot of strategizing and realignments have taken place after the crisis and Westfarmers is not an exception. A trend analysis shall provide us with information over whether Westfarmers is on its road to recovery or not. The directors' salaries are also scrutinized to determine whether they need to be reviewed as part of the recovery program.

Trend Analysis

In order to put into perspective the effect of the GFC, we shall study the profitability of the firm from 2007 to 2010. Ratios computed from the firm's financial statement shall provide us with an overall direction (Helfert, 2007).

As is the case for many firms, the net profit margin of Westfarmers decreased from 0. 114 in 2007 to 0. 039 in 2009. This may be attributed to the fact that the level of disposable income of consumers during the GFC decreased tremendously. However, a slight increase to 0. 043 in 2009 may be an indicator that business has started to look up for Westfarmers.

Decrease in disposable income is an external factor that Westfarmers has very little control on whatsoever. Dwindling sales is therefore not of Westfarmers making.

A decrease in the asset turnover in 2008 is also proof that business was low for the firm. We however notice a gradual rise from 2009 onwards, which may be an indicator that this company is on the path to recovery. The increase in the weighted average ordinary shares can explain the gradual drops in the debt to equity ratio and the leverage ratio. The company is using more equity than debt to finance its operations. This move should be highly lauded, as it would be catastrophic for the firm to continue accumulating debt.

Increase in equity finance as opposed to debt finance also boosts investor confidence and speaks volumes of the company's credit ratings. Despite the persistent drop in EPS from 1. 9 in 2007 to 1.

3 in 2010, it would be wrong to conclude that the firm has been posting poor results. Increase in the weighted average ordinary shares is the main reason why shareholders earnings have been on the decline and not profitability. Due to this, the debt to assets ratio has decreased tremendously from 0. 7 in 2008 to 0. 3 in 2010 (Friedlob, 2010). The steady rise in the current ratio from 0.

5 in 2007 to 1. 3 in 2009 allays any fears of incapability to meet maturing obligations. Due to the use of more equity capital, GFC has strengthened its current ratio thus a clear indicator that the firm is not under any kind of financial crisis. The balance sheet also provides evidence of the company's

liquidity as can be noted from the increase in cash and its equivalents over the years. The company did not invest any funds in associate companies in 2009 and this was a good move since this was the post GFC era and it was important to direct all energy and resources towards survival and not growth.

Scrutiny of Directors’ Remuneration

Reducing salaries is one of the most effective ways of bringing down the cost of production. The salaries of directors however always tend to be sticky despite the prevailing financial conditions.

The remuneration of Westfarmers directors must be scrutinized to establish whether there is need for review or not. According to the director’s report concerning remuneration, the salaries of Westfarmers senior executives are based on the market rates of the top 25 listed Australian companies. The wage rate is also pegged to the performance of the directors. There is a remuneration committee charged with the duty of structuring the salaries of directors. The work of this committee is not final, as it has to be approved by the board of governance. This provides sufficient checks and balances to ensure that the company’s senior management does not award them excessively. From the report provided, it is quite clear that the directors have no influence whatsoever on their remuneration.

Salaries are structured by an independent committee and vetted by the board in accordance to company law concerning remuneration. Remuneration structures and clearly laid out payment plans ensure that the salaries paid to the directors is not arbitrary. Everything is done according to

a well laid out legal framework hence we can conclude that the amounts paid are fair.

Conclusion

The objective of this report is to establish whether Westfarmers ltd is a viable investment or not. From the trend analysis of the company's financial ratios, we can deduce that Westfarmers is on its path to recovery from the global financial crisis. Profitability ratios such as the net profit margin and the asset turnover ratio indicate some slight fall in performance in the year 2008. However, the same ratios show tremendous improvement in the post GFC years of 2009 and 2010.

On the other hand, liquidity ratios such as the current ratio continue to strengthen in the years 2009 and 2010 indicating that the company's is not in any danger of going into receivership. The company has enough financial resources to cater for its maturing obligations. Increase in equity financing as opposed to debt financing is a good move and will go a long way towards helping Westfarmers recover from the GFC. It can also be seen from the financial statements that in the post GFC era, focus shifted from investments as no associates were acquired, this is good for stabilization of the firm.

This was well informed as acquiring more associates might have drained the company's resources and caused more problems in the short run. Being a company with associates there is diversity of risk as losses in the parent company can be offset by gains in its subsidiary and vice versa. This is evident in the income statements of 2008 and 2009. Despite there being a decrease in sales In the parent company, there was a general increase in the

consolidated sales. Such kind of buffering secures Westfarmers from any sudden changes in economic conditions as was witnessed during the global financial crisis.

Recommendation

From the financial statement, it can be seen that during the post GFC era, the company preferred equity financing to debt financing. Although this is good for survival and stabilization of the firm in the short run, it could be expensive in the long run.

Equity capital is more costly due to the floatation costs and other costs involved in acquiring equity finance (White, 2004). These costs inflate the expenses in the income statement and consequently eat into the company's profits.

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