Combined analysis of financial ratios

[Business](), [Accounting]()

The financial ratios that will be used include profitability, liquidity and gearing. Under profitability ratios are the net profit margin, operating margin, return on assets (ROA) and return on Equity. Under liquidity will be current ratio and quick asset ratios while under gearing ratio will debt equity ratios. The following table would help much in facilitating the analysis: The company's net operating margins showed 9%, 10%, 9%, 11%, and 12% for the years 2003, 2004, 2005 , 2006 and 2007 respectively or an average of 8% for the past five years. This ratios measure both profitability and efficiency (Brigham and Houston, 2002).

This ratio is already quite high since it means simpler terms that the company is earning 8 sterling pounds for 100-pound sterling revenues made from customers. Revenues are the quantified amounts of delivered products and services to customers. If net operating margins are compared with net profit margins of the company, one would find that the latter are should reflected at 7%, 7%, 5%, 7% and 8% or an average of 5% respectively. The latter rates are lower which is normal because further reduction is made from operating income before it could be divided to total revenues.

It indicates the company has been spending on the average a three percent (3%) difference between the two ratios. That difference represents a financing cost of about 3% revenues on the average or a cost of borrowing. The company is therefore a net borrowed of funds for the last five years. This will be confirmed by in the liquidity analysis. Since there is a perceived efficiency of the company also because of an average of 8% net operating margin, the same could be used as basis to motivate performance of managers under fifth Hermes principles.

Based on this the performance program may be evaluated on whether the company has in fact motivated managers to deliver higher share holder value. The answer to this issue will be result if could be resolved that stock price did improved during the period under review. The company’s returns on assets are shown at 8%, 8%, 8%, 10% and 13% for the years 2003, 2004, 2005, 2006 and 2007 respectively or an average of 8%. It might be observed that average ROA is the same with the average operating margin.

The two rates are however different. While both rates could be said to measure profitability and efficiency, the first one uses the total assets as denominator while the second total revenues. Thus it could be stated while the first measures how management uses company assets effectively, the second measures how much operating income is generated from total goods delivered or services rendered. In other words, while the first uses the amount of resources used in business as divisor, the others used the results of resources generated.

While all these ratios point to efficiency which much result to higher shareholder value or stock price, the return of equity has more direct relationships. Examining the company’s return on equity of Marks and Spenser PLC, reveals how the company has been doing in delivering shareholder values whether the latter are maximized or not. The past performances of the company over the last five years show are generally uniformly increasing as evidenced by recorded rates at 26%, 23%, 43%, 43% and 41% for the years 2003, 2004, 2005, 2006 and 2007 respectively or an average of 30% for the past five years.

It was only from 2003 to 2004 that temporary decrease was observed. It could just be described a cooling down period until it resumed a very remarkable increase from 23% to not less than 40% for the next three years thereafter. To have a return of equity of 41 to 43% would be an indication was not just doing well, it was doing very handsomely as it could be more than six times with what is normally earned under risk free investments of about 6%. At this point, the paper is now ready to discuss and analyze the liquidity ratios of the company.

The company liquidity may be measure by its capacity to meet its currently maturing obligations. The use of current ratios is the traditional way of doing its for which ratio the company showed 1. 61, 1. 92, 0. 41, 0. 57 and 0. 42 for the years 2007, 2006, 2005, 2004 and 2003 respectively or an average of 0. 66. The more strict measure is the quick ratios for which Marks and Spencer got 1. 43, 1. 72, 0. 24, 0. 38 and 0. 21 for the same years respectively or an average of 0. 51. What is evident is deterioration over the years and which are in contrast with the profitability behaviour of the company in terms of ROE.

Are not funds generated by operations tofinanceworking capital requirements when the business is profitable? Although the logical answer to the question is in the affirmative, it may be asserted management is always free to make choice on how to use the funds. What happened was instead to have increased borrowings by having higher current liabilities for the years 2005, 2006 and 2007. What investigation revealed is the need to sustain the expanding operation in 2006 which increased by at least 4% in total revenues and in 2007 when total revenues increased by 10% from the year preceding.

In addition the company used the funds to pay-off long term obligations hence the improvement if the company's level of gearing as would be seen in the next subsection. Another way to look at the financial reporting of the company is analysis of gearing. If there is way to measure liquidity to determine short term solvency, there must also be way to know the company'shealthas far as to long term debts are concerned in relation to its stockholders investments. Instead of liquidity, the name given is gearing or financial leverage.

The idea is to balance gearing and growth of the company. To grow with so much risk is far from being the desire of every investor. The debt to equity ratios are reflective of Marks and Spencer gearing for which the company was shown to have 2. 18, 2. 01, 4. 35, 3. 37 and 2. 26 for the years 2003, 2004, 2005, 2006 and 2007 respectively or an average of 2. 40. Knowing just the ratios without something to compare with will leave the reader groping for is good or bad.

For which this paper assumes that the level of debt should matched preferably with 100% investment from stockholders or a ratio of 1. 0 to be considered normal. The company appears to have more than doubled for the whole five year period. But as would be found latter the stock price of the company has increased in 2006 tremendously despite the highly leveraged position of the company. The only possible explanation is that the company was still in control despite the high risks that the company were undergoing.