

The effects of financial management and corporate strategy on a firms performance...

[Business](#), [Company](#)



\n[[toc title="Table of Contents"](#)]\n

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1. [Tesco and Carrefour](#) \n \t
2. [Research Aim](#) \n \t
3. [Research Objectives](#) \n \t
4. [Research Question](#) \n \t
5. [The following hypothesis will be tested:](#) \n \t
6. [Gearing Performance](#) \n

\n[/toc]\n \n

1. 0 INTRODUCTION

Tesco has grown in leaps and bounds over the years over the last two decades. Currently, Tesco is the second largest retailer in Europe and the third largest retailer. Carrefour, which is larger than Tesco, has a lower net income than Tesco. A research conducted by Bernstein Research indicated that the international prospects of Tesco have been underappreciated. In fact, it indicated that Tesco is better positioned for growth internationally compared to its competitors. Tesco has been a success story that has been studied by various researchers in an effort to unravel the reasons behind its success. Different researchers have attributed the success of Tesco on various factors including but not limited to; prudent financial management, advanced corporation technology, corporate strategy, outstanding leadership, strategic management and prudent retail management. This study seeks to ascertain the reason(s) why Tesco has a better financial performance than Carrefour by comparing their financial management and

corporate strategies. In also, it seeks to evaluate whether there is a correlation between prudent financial management, as measured by financial ratios, and financial performance. Lastly, it intends to evaluate whether corporate strategy has a bearing on financial performance

Tesco and Carrefour

Tesco is the second largest food retailer in Europe and the third largest in the world. Tesco was founded in 1919 by Jack Cohen. It has a head office at Chestnut in Hertfordshire. Tesco has approximately 530, 000 employees working in its 6, 351 stores. Tesco operates in 14 countries. In addition in have franchises in all over the world. Types of store managed by Tesco include; hypermarkets, supermarkets, discount stores, Cash & Carry/warehouse club, department stores, convenience stores, superstores, and other speciality supermarkets. Tesco deals with a diverse range of product categories ranging from food, home appliances, clothing, beverage, and clothing to financial services.

Carrefour is a largest food retailer in Europe and the second largest in the world after Walmart and Tesco. Carrefour was founded in France in 1958. It has it's headquarter in Boulogne Billancourt in France. Carrefour operates in Europe, United States of America, South America, Middle East, North Africa and Far Asia. Carrefour operates supermarkets, hypermarkets, convenience stores, Cash & Carry, multichannel stores, hyper cash stores and other speciality stores. Carrefour stores sell a wide variety of food items and beverages including perishables and basic groceries; non-food items including clothing and general merchandise. Both Tesco and Carrefour are in

the retail industry. They are direct competitors since they offer similar goods and services.

Research Aim

Tesco has grown in leaps and bounds over the years over the last two decades. It has overtaken Carrefour to become the largest retailer in Europe in terms of net income. What is it that Tesco is doing better than Carrefour? To identify the potential causes the researcher is interested in comparing the financial management and corporate strategies of the two companies. The researcher will evaluate financial management through financial ratios. The researcher is also interested in evaluating whether the difference in financial management, if any, explains the difference in financial performance. Consequently, the researcher will be interested in determining if there is a correlation between financial management, as indicated by financial statement ratios, and financial performance. In addition, the researcher seeks to compare the corporate strategies of the Tesco and Carrefour. Lastly, it seeks to evaluate whether there is a correlation between corporate strategy and financial performance.

Research Objectives

Based on the aims of the study, the following research objectives were deduced;

- Determine whether Tesco has a better financial management than Carrefour.
- Determine whether there is a correlation between financial management and financial performance.

- Determine the corporate strategies employed by Tesco and Carrefour
- Determine whether there is a correlation between corporate strategy and financial performance.

Research Question

The following research questions were deduced from the research objectives;

- Does Tesco have a better financial management than Carrefour?
- Is there a correlation between a firm's financial management and financial performance?
- What are the corporate strategies employed by Tesco and Carrefour?
- Is there a correlation between corporate strategy and financial performance?

2. 0 LITERATURE REVIEW

Financial statement ratio analysis has been used to assess the financial health and predict future performance and going concern assumption of firms for a long time. The theory of ratio analysis was popularized by Benjamin Graham who was a professor at Columbia Business School (CBS) and a successful investor. Graham and Meredith (1937) argued that it is difficult to predict the future with certainty because the future success of an entity depends on future developments. However, given precise information about an entity's past earnings record and present financial position, we are better equipped to evaluate the future possibilities of the entity. Empirical and tested evidence tend to suggest that financial ratio analysis is the easiest, clearest and offers the most logical set of indicators as to the current

performance and future performance of any firm. Samad (2004) studied the financial performance of 7 publicly listed commercial banks for 8 years; 1994-2001. The study used financial ratios to evaluate profitability, liquidity performance and credit quality. The performance of the 7 commercial banks was compared to that of the Bahrain Banking industry which was used as the benchmark. The study applied t-test in evaluating statistical significance for the performance measures. The study showed that Bahrain commercial banks were statistically less profitable, had higher credit risks and were less liquid. In the U. S. A, Hobarth (2006) evaluated the correlation between financial ratios and firm's performance of public companies in the U. S. A for 19 years using 17 financial ratios and 3 variables to measure financial performance. The study revealed that firms with an efficient working capital, low gearing level, high retained earnings and low liquidity have a higher profitability based on the Return on Investment (ROI). Therefore, there was a positive correlation between prudent financial management and firm's performance. On the other hand, firms with unqualified auditors opinion and high gearing ratio have a superior cash flow performance. Furthermore, firms with an efficient working capital, low gearing ratio and high EBIT margin have a superior market performance. Barac (2011) conducted a study to provide empirical evidence regarding the prediction ability of cash-flows ratios of sustainable firm performance using two methodological approaches; artificial neural networks and linear discriminant analysis. The study revealed that there is a significant difference between the cash flow ratios of non-sustainable financial performance companies and sustainable financial performance companies. Furthermore, it revealed that both the artificial

neural network and discriminant analysis had relatively good accuracy in predicting firm performance. Cheng (2012) conducted a study to evaluate the relationship between financial ratios and firm performance. The study used a sample of 70 banks; 35 non-failed banks and 35 failed banks from 2006 to 2010. The study used data for three years prior to the bank being declared bankrupt. The study used correlation analysis to determine whether there is a relationship between past financial ratios and financial performance of a firm. The study revealed that there is a correlation between a financial ratio and a firm performance which consequently determined whether a firm would become bankrupt. The study showed that financial ratio can predict a firm performance.

Several researchers have associated corporate strategy with financial performance distinguishing between strategies that are associated with high performance and those associated with low performance. Corporate strategies that result in high financial performance are identified with activities that lead to financial success. These activities are related to initiatives in the respective industry. Some of the initiatives identified by researchers include; product innovation, emphasis on product quality, technological innovation, product and market diversification among others. Strategies that involve initiative taking are referred to as pro-active strategies. On the contrary, firms with a dismal financial performance tend to react to events in their external environment. Such companies often adopt strategies which stress on risk avoidance and not innovation. They are referred to as reactive strategies. Reactive strategies are often mismatched with the environmental demands and are not well integrated. The activities

of improving existing products to match changing consumer needs, emphasising on product quality and developing new products are associated with increased market share by attracting new customers and retaining the existing consumer-base which will consequently increase sales revenue. On the contrary, low performing firms are likely to ignore such initiatives since they involve risks. High performance firms implement new technologies, emphasis cost-effectiveness and employee productivity. Such initiatives reduce operational costs and improve operational efficiency thus resulting in high operating incomes. Furthermore, Vickerey & Droge (2007) revealed that firms that aggressive marketing strategies, identification of product brand names, emphasis on customer service, customer support and credit have a positive correlation with financial performance. Their study revealed that firms adopting proactive strategies have a significantly higher performance than firms that adopt reactive corporate strategies. The findings are similar an empirical study conducted by Covin (2005). The study defined corporate strategy using 25 items from five corporate functional areas; production, HRM, finance, R&D and marketing.

3. 0 METHODOLOGY

3. 1 Target Population and Sampling

Theoretical population of this study is Tesco and Carrefour. A sample refers to a section of the target population. Sampling is used when the target population is too large to be studied in entirety. However, in this case the target population comprises of only two firms. Therefore, sampling will not be applied in this study.

3. 2 Data

This study will rely on secondary data to obtain the data required for the analysis. The study will use panel data of Tesco and Carrefour. The data will be obtained from the audited financial statements of the two companies. Information on the corporate strategies employed by Tesco and Carrefour will be obtained from the annual reports, management reports and investor relations reports. Tesco and Carrefour are public listed companies. Therefore, their financial statements are easily accessible in the public domain or from their official websites.

3. 3 Data Analysis

This study will use a descriptive financial statement ratio analysis in measuring, analysing, describing and comparing the performance of Tesco and Carrefour during the years 2008-2012. In addition, student t-test will be employed to examine whether the difference in financial performance of Tesco is statistically significant from that of Carrefour. Student t-test will be used to test the hypothesis that the mean of the two companies on the 11 variables detailed in section 3. 4 are equal.

The following hypothesis will be tested:

$$H_0: \mu_0 = \mu_1$$

Where μ_0 is the mean for Tesco and μ_1 is the mean for Carrefour. Inferences about the hypothesis will be made by comparing the critical values of the mean and the calculated test statistics. If $P\text{-value} \leq \alpha$, then the null hypothesis will be rejected or else it should not be rejected. The test will be conducted at 5% significance.

This study will also use Pearson Correlation coefficient to determine whether

there is any relationship between all the other variables and Return on Asset. In that case, return on assets will be the dependent variable while the other variables will be the independent variables. The null hypothesis for the Pearson correlation analysis is $H_0: \rho = 0$ for all the variables under investigation. Inferences about the hypothesis will be made using the calculated correlation statistic. If $P\text{-value} \leq \alpha$, then the null hypothesis will be rejected. If $P\text{-value} > \alpha$, then the null hypothesis will not be rejected. The test will be conducted at 5% significance level or 95% confidence level.

Corporate strategies employed by Tesco and Carrefour will be classified as proactive corporate strategies and reactive corporate strategies. This study will also use Pearson Correlation coefficient to determine whether there is any relationship between all corporate strategy and financial performance. The null hypothesis for the Pearson correlation analysis is $H_0: \rho = 0$ for the corporate strategies that will be identified. The alternate hypothesis will be $H_0: \rho \neq 0$ for the corporate strategies that will be identified.

Fig. 1: Conceptualized Model of the association between Corporate Strategies and Financial Performance.

3. 4 The Variables

3. 4. 1 Financial Management

Under financial management, the variables of interest to the researcher are the various financial ratios. There will be only one dependent variable which will be the return on assets. The other variables are independent variables. The variables were classified as performance ratios, liquidity ratios, asset management ratios and debt ratios.

- Profitability Performance

Profitability ratios indicate a firm's ability to control its cost of sales, operating expenses and financing expenses thus maximizing shareholder's wealth.

Gross Profit Margin = $\text{Gross Profit} / \text{Sales Revenue}$: Gross profit margin measures the percentage of total revenue that the gross profit represents.

Gross profit margin indicates a firm's ability to control its cost of sales.

Net Profit Margin = $\text{Net Profit} / \text{Sales revenue}$: Net profit margin measures the percentage of total revenue that the net profit represents. Net profit margin indicates a firm's ability to control its operating expenses and financing expenses.

Return on Assets = $\text{Profit after Tax} / \text{Total Assets}$: Return on assets is a measure of performance that shows the profit after tax relative to the asset base of the company. Return on assets will be the only dependent variable for this study.

- Liquidity Performance

Liquidity ratios indicate a firm's ability to meet its short-term and maturing obligations as they fall due. Liquidity ratios are based on the current assets and liabilities of an entity.

Current asset ratio = $\text{Current Assets} / \text{Current Liabilities}$: This liquidity ratio illustrates the extent to which the total current liabilities can be covered with the total current assets of a firm. The ratio is a measure of the company's short term solvency.

Acid Test ratio = $(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$: This liquidity ratio illustrates the extent to which the total current liabilities can be covered with the most liquid assets of a firm. The ratio is a measure of the company's

short term solvency.

- Asset Management

Asset management ratios measure a firm's effectiveness in managing their assets and measure the level of appropriateness of a firm's resources to its operations consequent of its revenue generation.

Inventory Turnover Ratio = $\text{Cost of Sales} / \text{Average Inventory}$: Inventory turnover ratio shows the average number of times that inventory is converted into sales in a year. Average inventory is the mean of the opening and closing inventory. It measures the efficiency with which a firm manages its inventory.

Inventory Holding Period = $365 / \text{Inventory Turnover Ratio}$: Inventory holding period is the number of days taken to convert inventory into sales. Just like the inventory turnover ratio, inventory holding period measures the efficiency with which a firm manages its inventory.

Fixed Asset Turnover Ratio = $\text{Sales Revenue} / \text{Fixed Assets}$: Fixed asset turnover ratio measures the number of a given currency units of sales revenue that is generated by a single currency unit of fixed assets. It indicates the efficiency with which fixed assets are managed in the generation of revenue.

Total Assets Turnover Ratio = $\text{Sales Revenue} / \text{Total Assets}$: Fixed asset turnover ratio measures the number of a given currency units of sales revenue that is generated by a single currency unit of fixed assets. It indicates the efficiency with which fixed assets are managed in the generation of revenue.

Gearing Performance

Gearing ratios indicate the extent to which a company has borrowed fixed charge capital to finance its acquisition of resources or assets of the entity. It shows how well a company is managing its debts.

Debt/Equity Ratio = Debt/Equity: Debt to equity ratio measures the number of a given currency units of debt for every currency unit of equity used to finance the assets of an entity. It measures the extent to which a firm is geared.

Debt Ratio = Total Debt/Total Assets: Debt ratio measures the proportion of assets financed by debt capital. It is given as a percentage. It ascertains the extent to which the company assets are financed by debt.

3. 4. 2 Corporate Strategy

Corporate strategies employed by Tesco and Carrefour will be the independent variables. Corporate strategies classified as proactive corporate strategies and reactive corporate strategies. Three measures of financial performance will be the dependent variables; sales revenue, operating income and net income. Figure 1 below shows the association between corporate strategies and financial performance.

Fig. 1: Conceptualized Model of the association between Corporate Strategies and Financial Performance.

4. 0 EXPECTED RESULTS

The researcher expects Tesco to have better financial management as indicated by the profitability, liquidity and asset management ratios. Tesco had a higher net income than Carrefour in 2012. Therefore, the difference between the various variables is expected to be statistically significant. The

researcher also expects that there would be a significant correlation between financial management and financial performance. According to Graham and Meredith (1937) financial ratios are a predictor of future performance.

Similarly, other researches also indicate that there is a correlation between financial ratios and financial performance. The researcher also expects that their corporate strategies employed by Tesco and Carrefour are different and that there is a correlation between corporate strategies and financial performance.

5. 0 CONCLUSION

This study will attempt to identify the potential cause(s) of the difference in financial performance of Tesco and Carrefour and whether those identified factors have a significant correlation with performance. One of the objectives of this study is to determine if the financial ratios of Tesco are statistically different from that of Carrefour. Student T-test should reveal that they are statistically different which explains Tesco superior financial performance. The other objective of this study is to determine if financial ratios are predictors of financial performance. Pearson correlation analysis should indicate that there is a statistically significant correlation between financial ratios and financial performance. The third objective was to determine the corporate strategies of Tesco and Carrefour. The study should reveal that Tesco employs more proactive strategies than Carrefour and fewer reactive strategies than Carrefour. The last objective was to determine whether there is a correlation between corporate strategy and financial performance. The study should reveal that there is a significant correlation between corporate strategy and financial performance.

5. 1 Limitations of the study

There are some noteworthy limitations that are expected to be encountered during this study. First and foremost, data will be obtained from only two firms which may not be a representative of the retail industry let alone all business entities. Therefore, the findings of this study may not apply to all business entities. Secondly, financial statements are subject to deliberate distortion and human error which it may be difficult to ascertain the accuracy of the included information. To minimize this risk, this study will rely on audited financial statements.

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