

Strategic financial analysis

Business



Financial ratios are capable to provide information about the performance of the company throughout various periods of time. The most important users of financial reports of the company include stakeholders, suppliers, analyst? adviser groups, equity investor groups and loan creditors, company's employees, and competitors.

Each of these groups has their own particular interest in the financial ratios marked in the financial report of the company and oftentimes, the ratio may be considered a positive factor by some of these groups, while for others it will be considered negative information about the company. Clothes retailer Next Plc. has represented outstanding performance during the last 10 years. The company's assets have grown vastly and profitability ratio has increased dramatically during this period of time. All of the financial indicators show that the company has entered the stage of fast growing and that its performance is only going to increase in the future due to the efficient policy which the management of the company is providing. Profitability analysis shows that the company presented an amazing increase during the year 2003 where its return on shareholder's fund displayed a number of 121%.

At the same time, the solvency ratio of the company is relatively low. The company was thus forced to start borrowing more due to the increased need in cash and investments into expansion, which eventually led to the increase of the debt/equity ratio. All of the mentioned financial indicators give different information to various groups interested in Next Plc. performance. For example, for shareholders, the profitability of the company is the most important indicators of their welfare.

The goal of every organization can be defined as profit maximization and increase in the value of shareholders. As long as profitability of the company is increasing, i. e., the revenues of the company are increasing faster than its costs, the shareholders are satisfied. For employees, high profitability of the company is also a favourable factor because they are able to benefit from the possible increase of salaries.

Besides, in such a case there is very little risk for employees to lose their jobs because the company is only going to increase the number of people working in it. For suppliers the increase of the profitability of the company is a signal to make connections with it even tighter because it will need more of their services and products in the future. Competitors regard information concerning the growing profitability of Next Plc. as a sign that they need to expand their activities in the market with great possibility of profiting and that they need to examine the activities of Next Plc. carefully in order to be able to compete with it.

At the same time, it is necessary to mention that high profitability ratio can also be an indicator of risky operations which the company is involved in. In case of Next Plc, it is not the reason because the company has simply obtained a larger share of the market in the recent years and the industry in which it provides its activities is growing rapidly. However, for many companies, a rapid increase in profitability might be dictated by risky operations they take and thus exposure of shareholders to the risk of bankruptcy. The analysis of operations which the company provides is particularly important for such groups as analyst? adviser groups, equity investor groups and loan creditors in order to make a conclusion about the <https://assignbuster.com/strategic-financial-analysis/>

risk exposure of the company. The low solvency ratio which the company has can also be interpreted in different ways. For example, for shareholders and employees this information means that all of the resources of the company are invested into assets which are going to bring profit to it in the following years.

For an organization similar to Next Plc. there is no need to have excess cash resources because they should rather be obtained through loans when they are needed. However, equity investor groups and loan creditors might consider it a negative factor that the company has limited cash resources when making a decision about financing. They are also interested in the debt/equity ratio of the company in order to find out which type of financing the company has been using during the last years. Excess borrowing which the company does in order to meet the needs for expansion and reconstruction as well as for hiring new personnel might be considered a negative factor in some situations. In this case, specialists of analyst? adviser groups can be employed in order to make a full analysis of the company's activities and come to a conclusion about the most efficient form of financing for the company.

Obtaining loans from financial institutions might be a more convenient way of financing for Next Plc. than issuing securities, but the final decision cannot be made without a detailed analysis. For suppliers, low solvency ratio is a totally negative factor because they expect the company to pay for their products and services in agreed terms, and lack of cash resources can prevent Next Plc. from doing that. Competitors can be interested in interpreting Next Plc.

's solvency ratio, as well as debt/equity ratio for different reasons, for example, in order to use some of the company's practices or to make conclusions about how to position their own companies better in the market. As the analysis of Next Plc. financial information has shown, it is impossible to make a general conclusion about the interpretation of financial indicators. Depending on the type of the user of financial information, the ratios are interpreted differently. Besides, each separate ratio does not bear all of the information about the performance of the company without a deep understanding of the company's operations, its history, economic situation in the market, its possible developments, as well as the number of competitors.