

Acg group

Finance



ACG group project Business organizations operate with the primary aim of making profits for sustainability, to facilitate growth, and to pay investors for their financial input into the businesses. Profitability ratios help users of financial statements to understand managements' effectiveness in generating profits from business operations and section reviews and compares profitability ratios of Baxter International and Becton, Dickinson and Company. Earnings per Share Earnings Per Share (EPS) is one of the commonly used and defines the amount of money that a business pays per share of its ordinary stock. The ratio is a significant indicator of returns on investors' money and influences interest in organizations' stock prices. It is computed by subtracting preference share earnings from net income after tax and dividing the remaining amount by the number of ordinary shares for an organization. The EPS is a strong profitability indicator because it is a derivative of profits. Baxter offered EPS of \$ 5.51 while Becton offered EPS of \$ 5.69. The high EPS for Baxter than Becton suggest higher profitability at Baxter than Becton because it the organization's net profits that influence the amount offered in EPS. The difference between values of EPS offered by the two organizations is also too wide to have occurred by chance and instead indicates differences in profitability. Observed differences in the two EPS ratios imply that investing in Baxter is more profitable than investing in Becton (Siddiqui, 2006). Profit rate Profit margin defines the ratio of gross profits to sales and shows an organization's efficiency in managing its cost of goods sold. Higher ratios shows better management of production cost towards better profitability. Baxter reported a gross profit rate of 0.51 percent while Becton reported a rate of 0.246 percent. The higher rate at Baxter therefore suggests better management of the organization's cost of

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sales and higher profitability. The rate is also consistent with the EPS and therefore supports the position that Baxter is more profitable than Becton. Two major factors could explain the difference. Baxter could be managing to sell its products at high prices and strategies towards competitiveness at such prices such as brand development and quality could be factors. The organization could alternatively be successful in minimizing its cost of production than Becton does in order to generate higher unit gross profit for similar commodity sale. The difference in EPS for the two organizations is however very large as compared to difference between profit ratios and number of common stockholders in each organization could explain this (Siddiqui, 2006).

Profit margin ratio The profit margin ratio a profitability measure that factors in expenses in sales. Examples of such expenses are sales commissions. It therefore explains managements' effectiveness in managing the expenses. The profit margin ratio for Baxter is 0.17 percent while the profit margin ratio for Becton is 0.073 percent. Higher ratio at Baxter shows that the organization is more efficient in managing sales expenses than Becton is. Direction of the difference is further consistent with direction of differences in profit rate and EPS and supports better profitability at Baxter (Jagels, 2006).

Return on asset ratio Return on asset ratio is a measure of organizations' efficiencies in managing their assets towards earning profits. A higher ratio means better utilization of assets in pursuing an organization's profit objectives. A comparison of the ratio among the two organization suggest better profitability at Becton that at Baxter. Becton reported a return on assets ratio of 0.22 percent while reported a ratio of 0.063 percent. The profitability indicator is different from other indicators in which Baxter shows better profitability but difference in value of the

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organizations' total assets could explain this. Baxter could be having higher value of assets to moderate the rate of return per unit asset value (Jagels, 2006). Asset turnover ratio The ratio defines the quantity of sales that an organization attains per unit value of assets. It is calculated as the ration of revenues to total assets and indicates management's ability to utilize assets to generate sales. The direct relationship between revenues and profitability, based on greater accumulation of profits, means that the higher the asset turnover ratio that an organization reports, the more profitable that organization is. Becton reported higher ratio, 3.02, compared to Baxter's ratio of 0.37. The ratio is also dependent on the organizations' value of assets and possible higher value of assets at Baxter than at Becton could explain this (Jagels, 2006). Becton indicates better profitability from return on assets ratio and asset turnover ratio but these ratios are highly influenced by an organizations' value of assets than the other profitability ratios that largely rely on income statement items. More prominence is therefore given to the EPS, gross profit rate, and profit margin ratio and the paper concludes that Baxter has better profitability indicators than Becton. Baxter also leads in more indicators, three, than Becton and this supports the position of better profitability at Baxter. References Jagels, M. (2006). Hospitality management accounting. Hoboken, NJ: John Wiley and Sons. Siddiqui, S. (2006). Managerial economics and financial analysis. New Delhi: New Age International.