Financial Analysis

Name

Institutional Affiliation

Inventory turnover is the ratio that shows how many times in a year in which a business converts its inventory into sales . It ensures that a business has enough inventory as compared to its sales level. A high ratio indicates that a firm is performing better since many customers come to buy as shown by increased sales implying that much of the stock is sold. A low turnover ratio indicates that few customers are buying from the firm and thus the sales are few while inventory levels are still high.

The receivables turnover of Wal-Mart Corporation is almost the same as that Amazon, but it is slightly higher. This means that Wal-Mart has more sales possibly because it sells most of its products on cash basis and can therefore extend credit to customers easily. Amazon seems to be selling more on credit and therefore most of its debtors haven’t paid and therefore cannot offer and more credit sales thus the low amount of sales. The inventory turnovers are as shown below:

Inventory turnover =

The cost of Sales
(Beginning Inventory + Ending inventory) / 2

**Walmart**

=3558069

(43803 + 44858) / 2

= 8.08 Inventory turnover

**Amazon Inc.**

62752

(7411+8299) /2

= 7.99 Inventory turnover

The Wal-Mart inventory turnover could be higher they manage their purchases well. They only purchase the inventory which they are sure that it is going to sell. The low value of inventory turnover for the Amazon Company could be because they do not know how to manage their purchasing system and thus end up buying a lot of stocks which remain idle at year end This may cause inventory to become obsolete and lose value.

Days in inventory is a ratio that shows the number of days that inventory was held in the warehouse before being sold. When receivables are compared to a business sales activity then the ratio is called the average collection period or the days sales outstanding. This comparison Is used to indicate the period within which customers pay off their dues to the company. A low ratio indicates better performance since it implies that customers buy more of the inventory within a shorter period of time. A high figure implies that customers take long to buy hence inventory is held for longer periods before being bought. It is calculated as shown below:

To calculate days in inventory, divide 365 days into the amount of annual cost of goods sold to arrive at sales per day, and then divide this figure into the average inventory for the measurement period. Thus, the formula is:

Average inventory
Cost of sales ÷ 365 days

**Walmart Corporation**

= (43803 + 44858) /2

3558069x 365

= 45

**Amazon Company**

**=** (7411+8299) / 2

 62752 x 365

= 46

Since Amazon had a lower turnover, its inventory would take a shorter time to be sold as compared to Wal-Mart Company.

Ratios are the best way to gauge the financial performance of any business. Managers use them in different firms in the following ways:

1. Evaluating if assets are being utilized efficiently to produce sales revenue.

2. Finding out if a firm is capable of meeting its short and long term liabilities whenever they fall due.

3. Performing an analysis of different firms in the industry by comparing a firms performance to that of its competitors in the same industry

4. Performing an analysis by comparing a firm’s performance with the industrial average of other firms in the same industry.

 5. Performing a trend analysis in order to gauge the performance of a firm over a certain period of time.

 6. To find out how much of firms assets have used the fixed charge capital for financing. 7. To find out a firms Z-score and compare it with the acceptable Z-score so as to determine the possibility of a firm becoming bankrupt in future.

**Limitations of Ratios**

Ratios have the following limitations:

1. They don’t take into account the size of a firm during cross sectional analysis. A firm may be compared to another one which is of a different size, technology and diversification of products.

2. They do not consider the effects of inflation on a firms performance. For instance, increased sales may be due to increasing the selling price as a result of economical inflationary pressure.

3. Ratios do not consider the non-quantitative characteristics of the firm such as customer loyalty, technological advancements and the corporate image.

4. The computation of ratios occurs only at a certain period of time and is affected by frequent changes thereafter such as cash changes and changes in stock levels.

5. Monopolistic firms rarely have competitors thus making cross sectional and industrial analyses difficult.

6. Ratios are mostly computed using historical past data on financial statements which may not be useful for future decision making.

7. There are other ratios which do not have predefined calculation formulas and thus their computations may be different in various industries.

8. The use of different accounting policies by different firms in the same industry limits ratio analysis. The depreciation methods and valuation of stock is different thus hindering comparison.

Out of the total assets that are required as a result of increase in sales, the financing will come from the two sources identified. Any amount that cannot be met from the two sources will be borrowed externally on short term basis which will be a current liability.

**References**

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