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MGT570: Financial Management

Module Assignment: Financial Report

Subject: Toyota's Financial Health Analysis

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Toyota's Financial Health Analysis

Toyota, a Japanese automotive giant, has been in operation for 86 years. The decades have been filled with a fair share of financial challenges and triumphs. This paper entails an assessment of Toyota's financial health over an extensive four-year duration. The primary emphasis is on crucial performance metrics, encompassing but not limited to profitability, asset utilization, solvency, and market-driven ratios. The objective is to furnish a robust evaluation of Toyota's fiscal position, ultimately resulting in the development of highly customized recommendations. These recommendations are intended to steer the company towards enduring financial strength and competitive persistence within the ever-changing automotive arena.

Performance Evaluation: Profitability

Gross profit Margin

(Gross Profit/ Revenue) *100 (Mahdi & Khaddafi, 2020)

Year 2019

$$(512,346 / 2,214,946) * 100 = 23.13\%$$

Year 2020

$$(506,432 / 2,171,355) * 100 = 23.32\%$$

Year 2021

$$(490,407 / 2,118,202) * 100 = 23.15\%$$

Year 2022

$$(607,682 / 2,705,183) * 100 = 22.46\%$$

Interpretation: Over the span of four prosperous years, Toyota has impressively sustained a remarkably stable Gross Profit Margin, signifying that an impressive 23% of its total revenue has been adeptly preserved as gross profit. This noteworthy achievement underscores the company's exceptional prowess in judiciously controlling its production costs vis-à-vis its sales, affirming its unwavering commitment to financial excellence.

Net Profit Margin

(Net profit/ Revenue) * 100 (Mahdi & Khaddafi, 2020)

Year 2019

$$(159,778 / 2,214,946) * 100 = 7.21\%$$

Year 2020

$$(150,187 / 2,171,355) * 100 = 6.91\%$$

Year 2021

$$(141,435 / 2,118,302) * 100 = 6.68\%$$

Year 2022

$$(185,350 / 2,705,183) * 100 = 6.85\%$$

Interpretation: The Net Profit Margin, which illustrates the proportion of revenue transformed into net profit, exhibited a modest decline over the years. In 2019, it stood at a robust 7.21%, signifying a substantial conversion of 7.21% of revenue into profit. However, by the year 2022, this metric had gradually receded to 6.85%. This observed trajectory suggests formidable challenges in operational expense management.

Return on Assets

(Net Income/ Total Assets) * 100 (Mubeen et al., 2014)

Year 2019

$$(159,778 / 5,261,174) * 100 = 3.04\%$$

Year 2020

$$(150,187 / 5,279,653) * 100 = 2.84\%$$

Year 2021

$$(141,435 / 6,503,986) * 100 = 2.17\%$$

Year 2022

$$(185,350 / 7,627,120) * 100 = 2.43\%$$

Interpretation: ROA, or Return on Assets, is a pivotal metric that gauges a company's proficiency in leveraging its assets for profit generation. Notably, Toyota's ROA experienced a gradual decline over the period from 2019 to 2022. In 2019, it stood at a commendable 3.04%, but by 2022, it registered a relatively lower figure of 2.43% hence implying that the company may have encountered challenges in optimizing its asset utilization to generate income during this time frame.

Efficiency

Asset Turnover Ratio

Net Sales/ Average Total Assets (Sunjoko & Arilyn, 2016).

Year 2019

$$2,214,946 / 5,261,174 = 0.42$$

Year 2020

$$2,171,355 / 5,279,653 = 0.41$$

Year 2021

$$2,118,302 / 6,503,986 = 0.33$$

Year 2022

$$2,705,183 / 7,627,120 = 0.35$$

Interpretation: This metric serves as a vital indicator of the company's adeptness at converting its assets into revenue. Notably, Toyota's Asset Turnover Ratio has exhibited fluctuations, underscoring shifts in its capacity to derive sales from its asset portfolio. For instance, in 2019, this ratio stood at a noteworthy 0.42 but witnessed a decline to 0.35 by 2022, indicating a perceptible deceleration in the company's sales-to-assets performance during this period.

Short Term Solvency

Current Ratios

Current Assets/ Current Liabilities (Husna & Satria, 2019).

Year 2019

$$1,623,784 / 957,365 = 1.70$$

Year 2020

$$1,739,883 / 974,314 = 1.79$$

Year 2021

$$1948081 / 1,188,239 = 1.64$$

Year 2022

$$2,255,827 / 1,372,721 = 1.64$$

Interpretation: The Current Ratio serves as a metric to gauge the company's adeptness in safeguarding its immediate obligations using its existing assets. Despite experiencing a marginal downward trend across the years, the Current Ratio managed to consistently maintain a level surpassing 1. This enduring pattern underscores Toyota's possession of a surplus in current assets vis-à-vis prevailing current liabilities.

Quick Ratio

(Current Assets – Inventory) / Current Liabilities (Husna & Satria, 2019).

Year 2019

$$(1,623,784 - 245,182) / 957,365 = 1.44$$

Year 2020

$$(1739883 - 255738) / 974314 = 1.52$$

Year 2021

$$(1,948,081 - 292,461) / 1,188,239 = 1.39$$

Year 2022

$$(2,255,827 - 433,961) / 1,372,721 = 1.33$$

Interpretation: The Quick Ratio, an exclusion of inventory from current assets, has experienced a mild decrease but still stands resiliently above 1. This signifies the company's ability to comfortably fulfill its short-term obligations without resorting to the heavy reliance on inventory sales, showcasing a solid financial footing in this regard despite the slight dip.

Long Term Solvency

Equity Multiplier

Total Assets/ Shareholder Equity (Abraham et al., 2017).

Year 2019

$$5,261,174 / 2,479,718 = 2.12$$

Year 2020

$$5,279,653 / 2,438,807 = 2.16$$

Year 2021

$$6,503,986 / 3,236,038 = 2.01$$

Year 2022

$$7,627,120 / 3,928,513 = 1.94$$

Interpretation: The financial leverage of the company is assessed through the Equity Multiplier ratio. Over the years, Toyota's Equity Multiplier has exhibited a declining trend, signifying a progressively conservative approach to its capital structure, featuring notably reduced debt in relation to equity. This strategic shift towards a more cautious capital allocation hints at a notable reduction in the company's financial risk, showcasing a prudent financial management strategy.

Market Based Ratios

Payout Ratio

(Dividend per Share/ Earnings per Share) * 100 (Dwinda & Stella, 2021).

Year 2019

$$(80 / 491.7) * 100 = 16.26\%$$

Year 2020

$$(80 / 469.85) * 100 = 17.10\%$$

Year 2021

$$(80 / 440.28) * 100 = 18.17\%$$

Year 2022

$$(90 / 580.78) * 100 = 15.50\%$$

Interpretation: Over the years, there has been a substantial surge in the Payout Ratio. This surge signifies a notable escalation in the proportion of earnings being distributed as dividends, showcasing a more pronounced inclination towards dividend distribution in relation to earnings.

Price per Earnings Ratio

Year 2019

11.28

Year 2020

11.02

Year 2021

22.39

Year 2022

14.58

Interpretation: The P/E Ratio measures the market sentiment's regarding the company's future growth prospects. It exhibited notable volatility, experiencing a remarkable surge in 2021. This surge strongly implies that market participants held exceedingly optimistic outlooks for the company's growth potential during that year.

Recommendations

Maintain and Enhance Profit Margins

Strategically addressing the notable downturn in Net Profit Margin stands as a paramount imperative for Toyota, as it endeavors to fortify its long-term profitability sustainability. This decline hints at a scenario wherein the corporation adeptly excels in revenue generation and steadfastly upholds a commendable Gross Profit Margin. However, it faces hurdles in the adept management of operational expenditures. Here are precise recommendations, meticulously

tailored to empower Toyota in the art of reigning in operational costs and enhancing the efficacy of overhead cost management:

Cost Analysis and Optimization

Toyota must urgently undertake an extensive and in-depth cost analysis, pushing the boundaries of exploration into all its operational expenses. This analysis should cast a wide net, leaving no stone unturned, scrutinizing not only manufacturing but also the sprawling realm of administrative functions. By gaining a profound insight into the cost drivers, the company can artfully orchestrate its prioritized endeavors in the pursuit of cost reduction (Hopp & Spearman, 2021).

Implement Lean Practices

Adopting lean principles, exemplified by the Toyota Production System can yield remarkable advantages. These methodologies are dedicated to eradicating inefficiencies, enhancing productivity, and slashing superfluous expenditures (Hopp & Spearman, 2021). Toyota possesses the capacity to employ lean techniques extensively across its supply chain and manufacturing procedures hence optimizing its operations and curtailing financial outlays to a significant extent.

Energy Efficiency Initiatives

Efficiently incorporating energy-saving technologies and sustainable practices can yield substantial benefits in curbing operational costs, particularly in manufacturing. Toyota should strongly consider allocating resources towards the adoption of cutting-edge energy-efficient machinery and process optimization. Moreover, initiating comprehensive energy audits and actively researching renewable energy alternatives can play a pivotal role in not only curbing utility expenses but also bolstering the company's commitment to sustainable operations hence strengthening its brand image (Malinauskaite et al., 2019).

Supply Chain Optimization

Evaluating and optimizing the supply chain is paramount for achieving significant cost savings, and Toyota should proactively scrutinize its suppliers for exceptional efficiency and cost-effectiveness. Engaging in rigorous negotiations to secure advantageous terms and exploring innovative sourcing alternatives should be prioritized. Furthermore, implementing just-in-time inventory management strategies can not only mitigate carrying costs but also enhance cash flow, thereby further bolstering overall financial performance (Shen et al., 2021).

Automation and Technology Adoption

Strategically allocate resources towards cutting-edge automation and advanced technologies, aiming to revolutionize production processes and substantially curtail labor expenses. The integration of automation serves as a pivotal catalyst, significantly augmenting operational efficiency while simultaneously minimizing the probability of errors, thereby elevating the overall caliber of the products (Hidayatno et al., 2019). Furthermore, the application of data analytics and predictive maintenance techniques holds the potential to meticulously fine-tune the operational workflows, unlocking newfound heights of optimization.

Employee Training and Development

Highly skilled and motivated employees significantly enhance efficiency and productivity within an organization (Kareem & Hussein, 2019). By strategically allocating resources towards continuous training and development initiatives, Toyota can cultivate a workforce that excels in their roles hence resulting in exceptional operational performance and cost control.

Flexible Work Arrangements

Leveraging adaptable work structures, like remote work and highly flexible scheduling, offers the potential to significantly diminish overhead expenses tied to office facilities and utilities. Furthermore, this strategic move has the added benefit of substantially boosting employee satisfaction and retention rates thus reinforcing the company's commitment to a modern and employee-centric work environment (Kareem & Hussein, 2019).

Cost Reduction Culture

Foster a culture that passionately champions cost reduction and operational efficiency across the entire organization. Empower and inspire employees at every echelon to proactively unearth cost-saving prospects, and generously recognize and incentivize ingenious cost-cutting proposals (Hopp & Spearman, 2021).

Continuous Improvement

To drive relentless enhancements within its operations, Toyota should consider adopting a continuous improvement methodology like Six Sigma. These structured approaches are designed to meticulously uncover and rectify operational inefficiencies (Siegel et al., 2019). They revolve around making gradual, sustained progress, resulting in substantial long-term cost savings.

Optimize Asset utilization

Maximizing asset utilization stands as a pivotal imperative in enhancing Return on Assets (ROA) for Toyota. An ROA on the decline signifies a potential underutilization of its valuable assets in income generation. To counter this trend resolutely and to extract the utmost value from its assets, Toyota can contemplate a range of targeted strategies:

Asset Maintenance and Upkeep

Consistent and proactive upkeep and enhancement of assets hold the potential to significantly elevate their operational efficiency and extend their lifespan. To achieve these goals, it is imperative to establish rigorous preventive maintenance schedules thus curtailing any disruptions and curbing the expenses associated with repairs (Jasiulewicz-Kaczmarek & Gola, (2019). Furthermore, the strategic infusion of cutting-edge equipment and technology into the existing framework stands poised to not only bolster productivity but also yield substantial reductions in energy consumption, marking a pivotal stride towards sustainability and cost-effectiveness.

Inventory Management

To maximize capital efficiency and warehouse space utilization, Toyota should consider the adoption of just-in-time (JIT) inventory systems (Lyu et al., 2020). These streamlined processes can significantly reduce carrying costs and enhance one's ability to allocate cash towards more lucrative opportunities. Furthermore, leverage advanced data analytics to refine demand forecasts with precision and fine-tune inventory management strategies for optimal results. This strategic approach not only unlocks greater financial flexibility but also minimizes the allocation of resources to excessive inventory, thereby facilitating more profitable ventures.

Market Expansion and Diversification

Toyota should boldly venture into untapped markets or hitherto unexplored market segments, strategically leveraging Toyota's considerable assets to maximize profitability. This could involve not only broadening its product lines but also venturing into burgeoning markets with substantial growth prospects (Mangesti, 2019). Moreover, diversifying into closely related industries could unlock promising avenues for optimizing asset utilization to an unprecedented extent.

Asset Liquidation

Toyota should strategically assess its underperforming or peripheral assets for potential divestiture as part of its comprehensive business optimization strategy. By either selling or leasing these assets, Toyota has the opportunity to liberate a significant amount of capital that can subsequently be judiciously reinvested in more lucrative segments of its operations. Notably, this strategic maneuver not only optimizes capital allocation but also streamlines the company's operational landscape, enhancing overall efficiency and focus (Kim & Kung, 2017).

Efficient Manufacturing Processes

Toyota should proactively embrace lean manufacturing principles as a paramount strategy to significantly curtail wastage and amplify the overall efficacy of its production endeavors. In pursuit of this transformative endeavor, Toyota can earnestly delve into the realms of cutting-

edge automation, advanced robotics, and data-driven technologies, meticulously orchestrating their integration within its manufacturing ecosystem. This holistic approach promises not only heightened productivity and efficiency but also an exceptional augmentation in output, derived from the judicious harnessing of its pre-existing assets.

Supply Chain Optimization

Toyota should engage in collaborative ventures with suppliers and distribution partners thus fostering an environment of synergy in the supply chain logistics. By orchestrating seamless supply chain operations, Toyota can not only minimize lead times but also significantly curtail transportation expenses, all while enhancing asset turnover. Ponder the prospect of forging strategic alliances with the suppliers, an initiative that promises to further elevate the overarching efficiency of the supply chain network (Shen et al., 2021).

Strengthening Short Term Solvency

Strengthening short-term solvency is crucial for Toyota to ensure that it can meet its immediate financial obligations efficiently. While the Current Ratio has remained above 1, indicating that the company can cover its short-term liabilities with current assets, the slight decline suggests a need for proactive measures to maintain a healthy short-term financial position. Here are specific ways in which Toyota can strengthen its short-term solvency:

Cash Flow Forecasting

Strategically cultivate resilient cash flow forecasting models of remarkable precision, meticulously designed to anticipate imminent cash requirements with unparalleled acuity (Ionescu & Neghina, 2021). By cultivating an unequivocal understanding of projected cash movements, Toyota can ingeniously allocate resources with foresight to effortlessly safeguard against impending expenditures thus mitigating the prospect of encountering liquidity shortfalls.

Efficient Receivables Management

Employ highly effective accounts receivable management strategies to accelerate cash collection significantly. These strategies encompass the prompt issuance of invoices, providing enticing incentives for early settlements, and vigilant monitoring of delinquent accounts. When the turnaround time reduces, the company can liberate a substantial amount of cash for immediate deployment while maintaining a robust financial position (Hung et al., 2021).

Inventory Optimization

Evaluate and strategically enhance inventory management practices to proactively mitigate burdensome holding expenses, all the while maintaining robust product availability. Deploy dynamic inventory turnover tactics to accelerate product sales and transform inventory assets into liquid capital with maximum efficacy (Lyu et al., 2020).

Dividend Policy Consideration

The Payout Ratio has experienced a remarkable surge, signifying a considerably larger portion of profits being distributed in the form of dividends. Toyota ought to thoroughly assess its dividend policy within the framework of its growth and reinvestment requirements. Striking an optimal equilibrium between generously rewarding shareholders and reserving earnings for prospective investments remains an imperative strategic consideration (Farrukh et al., 2017).

Enhance Long-Term Solvency

The persistent decline observed in the Equity Multiplier indicates a progressively cautious stance towards capital structure management. Although prudence in mitigating financial risk is indeed laudable, Toyota should explore the strategic deployment of debt to capitalize on potential avenues for expansion and investment. Striking a harmonious equilibrium between maintaining long-term solvency and pursuing ambitious growth objectives becomes increasingly pivotal in this context.

Market Perception

The Price-to-Earnings (P/E) Ratio has exhibited significant volatility, underscoring the considerable fluctuations in market sentiment that have been witnessed. In order to effectively address this situation, it is advisable for Toyota to adopt a strategy of utmost transparency in its communications with investors (Arena et al., 2015). This strategic approach would involve furnishing investors with comprehensive insights into the company's growth strategies as well as its financial prospects.

Project Recommendation

The proposed initiative involves the conception and rollout of an economical electric vehicle (EV) by Toyota, reflecting a well-considered stride towards seizing the burgeoning desire for environmentally-conscious and reasonably priced transportation alternatives. The realm of cost-effective EVs is progressively gaining eminence in the landscape of automobile manufacturing, propelled by concerns for the environment, governmental incentives, and evolving consumer predilections. Toyota's immersion into this sphere not only conforms to the worldwide shift towards sustainable commuting but also capitalizes on the firm's longstanding eminence for excellence and pioneering. Through the provision of a budget-friendly EV, Toyota aspires to democratize electric mobility, catering to a broader demographic thus extending its market grasp and contributing to an ecologically-conscious tomorrow. The feasibility and profitability of the endeavor will be meticulously evaluated through exhaustive financial scrutiny, guaranteeing its harmony with Toyota's strategic objectives, all while bestowing value upon stakeholders.

Evaluation using NPV

In order to ascertain the viability of embarking on a cost-effective electric vehicle (EV) initiative as a strategically prudent step for Toyota, it becomes imperative to conduct an exhaustive financial analysis. Within this evaluation framework, the Net Present Value (NPV)

and the Weighted Average Cost of Capital (WACC) emerge as two pivotal instruments playing a decisive role.

Net Present Value (NPV)

NPV offers a powerful means to evaluate a project's profitability, placing significant emphasis on time value of money. In practical terms, this process involves the estimation of prospective cash flows stemming from the EV project, encompassing not just revenues but also the intricacies of costs. These cash flows must be projected meticulously, spanning the entire lifespan of the project. Following this, a discount rate is ascertained, often drawn from the company's cost of capital, carefully adjusted to encapsulate the unique risks inherent in the EV project. By skillfully discounting these future cash flows back to their present value, Toyota will effectively evaluate the viability of the project. A positive NPV serves as a potent indicator, affirming that the project is will deliver returns that far surpass the upfront investment (Žižlavský, 2014).

Using Retained Earnings

Opting to finance 40% of the project with retained earnings presents Toyota with several notable advantages.

Benefits of Using Retained Earnings

Financial Autonomy

Leveraging its substantial retained earnings, Toyota strategically empowers itself to seamlessly finance the project, sidestepping any need for external debt or the dilution of ownership by external investors. This approach safeguards the company's financial sovereignty and unwavering authority in steering its operations (Bierman Jr & Smidt, 2012).

No Equity Dilution

Unlike issuing new equity, the utilization of retained earnings stands out by its non-dilutive impact on ownership and voting rights. The unaltered equity interests of current shareholders

stand resilient, a particularly enticing outcome for enterprises aiming to sidestep any erosion in their authoritative command (Bierman Jr & Smidt, 2012).

Immediate Deployment

Retained earnings epitomize the readily accessible financial reservoirs within the organization, ensuring swift project initiation, obviating the necessity for protracted external fundraising or cumbersome approval procedures (Bierman Jr & Smidt, 2012). This substantial financial resource empowers the company to swiftly embark on its endeavors.

Strengthening Balance Sheet

Leveraging retained earnings significantly fortifies the company's balance sheet by transforming the accrued profits into substantial assets and high-yield ventures. Consequently, this robustly reinforces the company's financial standing and creditworthiness, exemplifying a judicious utilization of its financial resources (Bierman Jr & Smidt, 2012).

Retained Earnings Decision

Retained profits represent the financial gains an enterprise opts to reinvest within its operations, rather than disbursing them as dividends to its stakeholders. Following an exhaustive evaluation of the company's performance, the conclusion has been reached that Toyota should allocate a portion of its retained earnings for disbursement. Nevertheless, it has been previously suggested that Toyota allocate a portion of these earnings for the Electric Vehicle (EV) project, and consequently, a certain proportion of retained earnings must be reserved for this initiative. Several critical factors were taken into account when deliberating the decision to distribute a segment of the retained earnings:

Gross Profit Margin

Over the years, Toyota has consistently upheld an impressive gross profit margin, hovering at a robust 23%. This remarkable achievement underscores the company's remarkable mastery of cost management and its prowess in generating substantial revenue. These results bear witness

to Toyota's financial robustness, assuring not only the ability to cover operational costs but also the potential for generous dividend distributions.

Net Profit Margin

Over the course of several years, the net profit margin has undergone a gradual reduction, signifying the intricate task of effectively overseeing operational costs. Although this decrement could potentially instigate inquiries into the corporation's capacity to consistently yield earnings, it's important to note that the margin, while exhibiting a moderate decline, remains sufficiently robust.

Return on Assets (ROA)

The gradual decrease in ROA (Return on Assets) metrics for Toyota points towards a concerning trend, signifying a potential erosion in the organization's capacity to extract profits from its assets over an extended period. This adverse trajectory might stem from formidable obstacles in the pursuit of optimal asset utilization. The steadily diminishing ROA underscores the critical imperative for Toyota to embark on a revitalization journey aimed at enhancing the efficiency of its asset base. This strategic maneuver should take precedence over contemplating substantial dividend disbursements, as the company's future financial health hinges on reinvigorating its asset efficiency.

Short-Term Solvency (Current and Quick Ratios)

Over the years, Toyota has consistently maintained its current and quick ratios well above 1, showcasing the company's exceptional capability to comfortably offset short-term liabilities with its readily available current assets. This substantial financial strength underscores Toyota's robust capacity to efficiently handle short-term obligations, even when factoring in dividend payments.

Conclusion

The performance evaluation of Toyota has provided valuable insights into its financial health and strategic considerations. Toyota has demonstrated impressive stability in its gross profit margin and maintained healthy short-term solvency indicators, indicating its ability to meet immediate obligations. However, there have been challenges in managing operational expenses, optimizing asset utilization, and sustaining return on assets (ROA). The recommendations, encompassing cost optimization, asset utilization improvement, strengthening short-term solvency, and strategic allocation of retained earnings, collectively chart a course for Toyota's sustained financial excellence and competitiveness. While Toyota has the financial capacity to distribute dividends, it is essential to balance this with the need for reinvestment to address operational challenges and capitalize on growth opportunities. The recommendation is to allocate some of the retained earnings for a strategic project, such as the development of a low-cost electric vehicle (EV). This approach leverages the company's financial strength while positioning it for future growth in a rapidly evolving automotive landscape.

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Appendices

- **Appendix A: 2019 Financial Summary**

Sourced from:

https://www.toyota-industries.com/investors/items/2019_annual_financial_report_E.pdf

- **Appendix B: 2020 Financial Summary**

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- **Appendix C: 2021 Financial Summary**

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- **Appendix D: 2022 Financial Summary**

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