COVER PAGE AND DECLARATION

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Student's Full Name:	MOHAMED ABDEL MONEM HOSNY ZANOUN
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E-SIGNATURE : __________Mohamed Zanoun_________________________

DATE: _________15-08-2023_____________________________

EIU Paris City Campus
Address: 59 Rue Lamarck, 75018 Paris, France | **Tel:** +33 144 857 317 | **Mobile/WhatsApp:** +33607591197 | **Email:** paris@eiu.ac

EIU Corporate Strategy & Operations Headquarter
Address: 12th Fl. Amarin Tower, 496-502 Ploenchit Rd., Bangkok 10330, Thailand | **Tel:** +66(2)256923 & +66(2)2569908 | **Mobile/WhatsApp:** +33607591197 | **Email:** info@eiu.ac

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IKEA

Introduction

Competition among businesses in the recent decades became very stronger than before due to multiple reasons, the increased awareness of the consumers, clients, and publics about the available domestic and international varieties and the practices of marketers to promote for their offerings. The excessive employment of social and electronic media, which enable to market more effectively and efficiently than the traditional media. (Zhytar, 2018)

Financial analysis plays a vital role in the success and sustainability in the dynamic competitive environment as it enable the decision makers to investigate the validity of their strategies, employed and decisions made for the success and profitability. The financial analysis can plan and direct all the operations, and transaction through various analysis techniques either before launching a project; this can be supported with the feasibility studies, cash flow analysis and various capital budgeting techniques for the operating and carrying businesses. The firm can employ vertical and horizontal analysis for the data in the financial statements, cash flows, income statement and balance sheet or it can use ratio analysis as these ratios will cover multiple functional and strategic areas; liquidity, debt, profitability, efficiency and market. The analysis may diagnose the strengths and weaknesses to modify the existing strategies especially when compared the results with the industry indicators. (Valaskova, 2020)

General Background about the company

IKEA company in brief

IKEA is one of the most famous international businesses. The company was established in 1943 by Ingvar Kampard in Sweden. The company has multiple stores in all over the world as it works in more than 50 countries. The company works in the furniture, indoors, home appliances and tools and lately works in smart houses. Smart lighting and food in its stores to empower the value added to the consumers served.

The company vision: the company is working under a clear vision that directs and guides all its activities and operations to achieve the desired goals and objectives. The vision states that "To create a better everyday life for the many people". As noted, it focuses mainly on the consumers and publics served and aim to maximize the quality and standard of living of all people.

The mission: on the other hand, the company has a great mission that state "to offer a wide range of well-designed, functional home furnishing products at prices so how that as many people as possible will be able to be afford them." IKEA - Statistics & Facts | Statista

The company succeeded to combine the traditional and physical business and online to comply and adapt with the dynamic change in doing business and its online sites work effectively. IKEA - Statistics & Facts | Statista

Performance evaluation 2019 – 2022

In this section the analysis of the performance of the company depending on the financial analysis using the financial ratios for the period (2019 – 2022). To analyze the key functional areas, liquidity, profitability, and other functional areas to assess the key strengths and weaknesses in the performance to suggest all corrective actions if needed. To facilitate the analysis process the researcher summarize all the key indications and measures used in the analysis from the financial reports used from 2019 – 2022. (Correa, 2020)

Summary of the Key figures of Ikea 2019 – 2022

Years Item	2019	2020	2021	2022
Total assets	21470	21107	21407	224684
Current assets	9152	9162	9743	13384
Current liabilities	5980	5265	5608	9180
Inventory	4312	3661	3752	6294
A|R	4692	5276	5831	6906
Total liabilities	13172	11566	11292	14837
Net profits	1485	1731	1433	710
Grass profit	4056	4230	4478	4174
Operating profits	1856	2224	1856	1034
Interest expenses	370	420	361	353
Eps	-	-	-	-
Market price	-	-	-	-
No. of shares	-	-	-	-
CoGs	21128	19389	21137	23404
A|P	-	-	-	-
Total revenues	25184	23613	25615	27578
Cash	225	153	160	184
Dividends paid	500	600	850	1000
Fixed assets	11945	12313	11664	11300

Profitability measures

To assess the profitability condition in the company within the years 2019 – 2022, it is useful to summarize the data and the computation process within the following table:

	2019	**2020**	**2021**	**2022**
Net profit margin: Net profit / sales	5.9%	7.3%	6%	2.6%
Gross profit margin: Gross profit / sales	16.1 %	17.9 %	17.5 %	15.1%
Operating profit margin: operating profit / sales	7.4 %	9.4 %	7.2 %	3.8 %
ROA: Net profit / total assets	6.9 %	8.2 %	6.7 %	2.9 %
ROE: net profit / equity	17.9 %	18.1 %	14.2 %	7.2 %

As seen, the profitability at 2020 was the greatest one in all the measures, whereas, 2022 was the least one.

Although, the company succeeded to increase its revenues in 2022 compared with all the previous years, but the COGs (cost of goods sold) was the highest one due to the significant changes in the inventory, increased prices and operating expenses which lead to decreased profits. Especially that, the company seeks to introduce more values added for the consumers through more sales and discounts to attract new segments and expand in the emerging markets. (Khalifa, 2013)

Efficiency

These ratios assess the efficiency of the employment of various assets and capabilities. To summarize these ratios effectively, the researcher summarize these ratios in the following table:

	2019	2020	2021	2022
Total assets turnover Sales / T. A	1.173 times	1.12 times	1.2 times	1.12 times
Inventory turnover CoGs / inventory	4.9 times	5.3 times	5.63 times	3.72 times
A|R turnover Sales / A|R	5.4 times	4.5 times	4.4 times	4 times

As shown in the previous table, there is a simple fluctuation in all the efficiency indicators in total assets turnover in 2020, there is smaller decreases than 2019 and small increases in 2021 compared with 2020. In 2022, the ratio decreases again. The best ratio for inventory was in 2021 (the greatest), which means that the company succeeded to sell more times in this year. The highest A|R ratio (less time to receive the amount due at consumers), was in 2019 and this ratio gradually decreased in the following years to reach to its smallest value in 2022. (Begrade, 1989)

Short-term Solvency or Liquidity ratios

These ratios assess the capability of the company to manage its short-term obligations and liabilities. This can be summarized in the following table:

	2019	2020	2021	2022
Current ratio Current assets / current liabilities	1.53 times	1.74 times	1.74 times	1.46 times
Acid – test: current assets – inventory / current liabilities	0.81 times	1.04 times	1.07 times	0.77 times
NWC CA – CL	3177	3897	4135	4204
Cash ratio Cash / Cl	3.7 %	2.9 %	2.85 %	2 %

The previous analysis of the short-term solvency reveals that, the company has a relatively strong financial position at its current ratios is more than 1.45 (in approximately all the years). The greatest one was in 2020 and 2021 (1.74) and similarly in the acid tests and other excluding the value of inventory, the company has a reasonable coverage ratio for its liabilities (short-term obligation) through its speed or more liquid cash items. (Knezevic, 2009)

Long-term Solvency

These ratios assess how the company finance its operations and assets through the owned capital or external financial debts.

	2019	2020	2021	2022
Debt ratio Debt / TA	61.4 %	55 %	52.7 %	60 %
Debt – equity ratio Debt / T Equity	159 %	121 %	112 %	151 %
Interest coverage ratio: EBIT / interest expense	5 times	5.3 times	5.14 times	2.93 times

The previous analysis for long-term Solvency ratios reveals that, the company depends more on the external sources to finance its long-term needs as the debt ratios represents at least 52.7 % (in the least year or 2021) up to 61.4 % in (2019). The ratio of equity participation. Therefore is smaller than the external sources, but the company due to its efficient and effective management of its operation. Profits achieved empower its ability to pay the financial costs (interest expenses) as it is an acceptable ratios in all the years except 2022 (only 2.93 times). (Rankovic, 1989)

Market-based Ratio

These ratios assess the market conditions and focus mainly on the fluctuations in either the dividends, or the changes in the market price of the stocks and how this direct or guide the investors in the market (current and potential) as the increases in the market price which due mainly to the increased dividends received or the practices and strong financial position of the company. This encourage the existing and potential investors to buy more shares and V. V.

The company is a private company, and has no outstanding shares in the market which means that there ratios cannot be completed for the company. (Kenzevic, 2009)

Suggested recommendations to improve the performance of the company

From the previous analysis for the diversified functional and strategic financial operations, it is suggested for the decision makers at IKEA to improve the performance and sustain adequate and reasonable one to;

Interest more in the electronic operations in e-businesses which is not only more effective and efficient than the physical or traditional business (due to the reduction costs paid in the stores, decoration, depreciation) and the interactive and more positive relationship with the consumers, publics and other business partners through the e-business. These savings will not only increase the market share and attract new segments, but also enable the firm to increase the delivered value added to the consumers and maximize their loyalty and satisfaction.

The company allocate adequate interest for the recycling and environmental issues to comply with SDG's and the increased calls for more cleaner production and more active participation for the pollution problem. These efforts should promoted more excessively via the traditional and electronic channels to improve the image of the firm in the minds and eyes of all the clients, publics and other stakeholders' parties. (Zhytar, 2018)

It is also recommended for the company to reduce the debt ratio or the increased dependency on the external debts. This can be simply through increasing the equity ratio. This will raise the equity participation and reduce this financial risks due to the increased debt or liability. One of the key to reduce the dependency ratio is to increase the investment in the current assets as the current ratios or the short-term solvency is considered not the optimal one either the company has a good or strong financial position.

The company as known invests strongly in the forests and agricultural land to support its factories with the significant materials used; the wood, and this participates significantly to reduce its operation costs and improve its competitiveness among its competitors. So, there is a significant need to employ the research and development programs to find another alternatives and substitutes can be effectively used and replace the traditional wood.

The company also pays reasonable interests for the recycling reduce and reuse (The 3R's of sustainable solutions) but it is a must to invest more in promotional and marketing activities to declare and announce adequately for these efforts which can enhance its image in the minds of clients and publics. (Valaskova, 2020)

It is finally recommended to do an extra analysis for all the costs, expenditures to find the most effective and efficient means to improve the profitability indicators. In 2022, the company has the lowest profitability indicators although the revenues generated in 2022 was the greatest. So, the key problem is the increased costs and expenditures which impose the decision makers to find which area that can be diagnosed more and as possible reduce its costs to minimize the overall expenditures and costs to improve the profits.

Recommended new investment for the company and how this if the company can only capitalize 40% through own capital

There is multiple new projects or investment can be recommended which enable the company to expand in the market. The company can produce how appliances to invest its great image and promote the new bands under its name IKEA. The proposed factory can produce over refrigerators, fans, TV and washing machines and other consumption goods. The expected initial capital for the proposed project is 800 million and the expected net profits generated within the first 8 years are expected be;

Y1	80000	Y3	90000
Y2	110000	Y4	140000
Y5	180000	Y6	180000
Y7	240000	Y8	280000

When the company can only inject 40% of the project which means that the remaining required investment will be

800000 x 60% = 480000

So, the initial investment structure will be;

Loans	480 m
Equity	320 m

a) To compute the NPV (which is one of the most adequate analysis technique such as payback period, IRR and NPV). When the expected interest or discount rate is 8 %

so the NPV =

$$\frac{80m}{(1+0.08)^1} + \frac{110m}{(1+0.08)^2} + \frac{90m}{(1+0.08)^3} + \frac{140m}{(1+0.08)^4} +$$

$$\frac{180m}{(1+0.08)^5} + \frac{180m}{(1+0.08)^6} + \frac{240m}{(1+0.08)^7} + \frac{280m}{(1+0.08)^8} - (800m)$$

= 74.074 + 154.32 + 71.445 + 102.9 + 122.5 + 113.43 + 140.04 + 151.28 – [800] = 129.28 m US $

WACC or weight average cost of capital

To compute WACC;

The weight of equity is 40 %

The weight of loan is 60 %

The cost of the loan (interest rate) is 8%

The cost of equity is 10.5 %

So, WACC =

(0.4 x 10.5 %) + (0.6 x 8 %)

= 9 %

This means that, the average accounting return should be greater than 9 %. In the computation of NPV, the NPV computed was a positive value, (129.98m) which means that, the proposed project is a feasible as it not only cover its initial cost, but it will achieve additional profits (net value) with 129.98.

This can be empower the decision of the acceptance of the project. The average revenue rate $\frac{129.98}{80}$ = 16. 25 %

The previous results indicate that the proposed project is acceptable either through the positive NPV obtained through the analysis of the returns expected to be received within the first 8 years (as the remaining returns after the 8 years is ignored), and either through the average returns. The project has adequate return which is greater than WACC. Simply, the project can easily cover its cost of finance.

The using of its own cash or retained earing in financing using retained earnings is one of the most flexible and fast source of financing. Another key advantage of using RE (retained earnings) is that, there is no fixed liability to pay interest or dividends. Also, there is no interference when a company utilize or employs its existing RE as a company's own money or in the other words, the company has no need to issue new shares (in our case, there is no need to inject more capital by the owners or the partners in the company. (Rankovic, 1989)

On the other hand, the injecting of the new equity by the partners or the owners of the businesses (or even additional paid, in capital) does not affect directly boost RE, but it can lead to higher or more RE in the future or in the long time.

So, the sum, RE is preferred due to three basic advantage:

- Cheaper
- Faster
- And more flexible

So, it is preferred for the company to employ and invest its RE to finance the proposed or any new investments. But in the case of IKEA, there is no RE mentioned on the financial statement (only previous) which means that, after RE as a safe source of finance, the company (IKEA), can use additional investment injected by those owners or partners of the company.

<u>Does the company should pay return earning or not</u>

The decision of distributing the dividends or the return earning in based on the orientation of the company and its philosophy for investment, its competitiveness, on position among its competitors in the market. The firms may choose one form those time basic alternatives.

When the company is growth – focused company which means that, there are many clear and flexible alternatives or opportunities in either the current markets (domestic or international) or the potential markets. This means that, it is more safe (less risky) to use its existing RE in the investment to avoid the financial risks (especially when there is great fluctuation in the economic condition and a great probability to not achieving the desired sales and revenues that can compensate or cover the interests paid on the loan's liabilities.

In such cases, it is preferred to not distribute the returns on the shareholders or owners and allocate these return for the investment. When there is no greater competitors or the company has a great competitive

advantage or lead the market, there is no risk to not distribute these return and allocate these returns to invest or finance the proposed projects or investments.

On the other hand, as the second alternative, the company can or should distribute the return earnings as dividends for the owners or shareholders only when there is great competition in its industry and the company has weak operational or functional competitive advantage. The dividends can not only satisfy those current investors (or owners). But can attract additional or new investors especially when the investors current and potential has great or adequate experience in the stock market. The more dividends will increase the value of the stock in the market (due to the increased demand by those current and potential investors whom encouraged due to this increased dividends to inject more money in such stocks). This will maximize the value of the business in the market.

The company can employ this strategy, when there is no attractive investment or attractive opportunity to invest and the current interest rates in the market (either through the banking system or through the capital market through the bonds) is low or attractive to substituted the equity financing by the debt loans or band loans; the analysis of the related financial risks is required heavily here to overcome any default risks due to the great fluctuation in the economic conditions or the recession era in the business cycle. (Correa, 2020)

Conclusion

The financial analysis for the financial data of IKEA Company, which extracted from the financial statements at the annual reports for the period (2019-2022)

Through the most commonly used analytical method: the financial ratios reveals that the company has a strong financial position and adequate performance for all the functional areas (liquidity or short-term solvency, profitability, long -term solvency, efficiency)

The last year was the least one and this is mainly due to the increased costs and expenditures. The company seeks to expand globally especially in the emerging markets and on line to utilize from the efficiency of electronic business

The company should employ more R&D to reduce the cost of operations, which is the main reason behind the decreased profitability in 2020.

The company should also increase the equity participation to reduce the financial risks and reduce solvency rates.

The proposed project the company can invest and expand its operation is to produce home appliances, which is considered a feasible through net present value and WACC.

The financing through the retained earnings is fast, more flexible and more efficient than debt or issuing bonds or new stocks.

The company pay retained earnings to satisfy the existing investors and attract new ones and can save these retained earnings when there is an attractive investment and the loan as expensive or there is a great fluctuation in the economic conditions.

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