Financial Analysis

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For this assessment, American Airlines has been chosen as a company, and expenses will be discussed for this company. Our recommendation will be to decrease expenses and, more specifically, the operating expenses for the company. In general, this decrease will result in an increase in gross profit for the company, and in turn, the net profit will be increased. Net profit will then be added to the equity section in balance sheet, which will mean that the company will have to increase assets or its resources.

From the manager's perspective, we can say that decreasing the expenses will show their efficiency in terms of operations. However, there may be other reasons for decreasing expenses, including an overall company policy to reduce expenses, but that will also be possible with the help of positive cooperation from managers. There are two basic types of expenditures incurred by the company, namely, direct and indirect expenditures. Direct expenditures are the ones that are directly identifiable with a product or service. In other words, all expenses which are necessary for the company to provide service to its client are all direct expenses. Indirect expenses are also called discretionary expenses because they depend on the company's discretion whether to make these expenditures or not. In fact, the probability of decreasing these expenditures is much higher as compared to direct expenditures. On example can be given regarding administrative salaries which can be reduced by staff redundancy at small levels. This will decrease expenses and improve overall financial position of the company. In addition to a decrease in administrative expense, improving the overall processes will automatically decrease the expenses. In essence, decreasing expenses will show efficiency.

From the organizational perspective, decreasing expenses will be very much beneficial both in the short and long run business. In the short run, the overall financial position of company will be improved, including the gross profit and net profit. The net profit becomes a part of statement of owner’s equity and then adjusted in balance sheet. This means that decreasing expenses will ultimately increase the assets of company because they will have to be balanced against the increased equity. This improved picture of business will attract investors in the form of shareholders or loan forwarding institutions. The existing shareholders will also benefit from the increased net profit terms of increased dividends paid to them. In the long run, company can make this aspect a competitive advantage to compete with other firms in the industry. Cost leadership is a strategy the helps the company keep its cost as low as possible, and other competitors cannot compete on this aspect. Competitive advantage is not very difficult to develop, but it is very difficult to sustain.

If we take a look at the income statement of American airlines (news.aa.com, 2019), we will see the actual impact of decreasing expenditures on its various elements. Operating expenses are 94% of the total revenues, which means that gross profit is only 6% of the revenue. An effort can be made by the internal managers to decrease these operating expenses. For this purpose, an in depth analysis of these costs will be required. The company is involved in air travel operations, which may have higher costs, so it may be difficult to cut costs. The fuel costs may make a huge part of company operating costs, and company can apply point to point policy with its aircraft. Under this method, the aircrafts of company will be able to take off from most of the airports in the world as opposed to having a central hub in one place. The maintenance cost will also be a huge part of company costs, and company can assure that it searches for the lowest bidder around the world regarding these services. Preferably countries that are labour intensive will provide inexpensive maintenance services to the company. Salaries and wages also form a considerable part of direct expenses, but a company cannot reduce operational employees in the name of redundancies, because these employees are critical to the company as they will include crew and other technical staff. Interest expense has formed a considerable portion of the non-operating expense, and the company can reduce this expense to a certain extent. The nature of company’s business is such that it has to take a certain amount of loans from various sources; if the company improves its overall financial position to attract more shareholders, it will have to take lesser loans and pay lesser interest.

The reduction of expenses will affect loaning agencies as well in terms of improvement of overall picture of the firm. An agency will forward loans to a company easily if the financial position of company is better as compared to other firms in industry. Better financials will assure them that their loans will be paid back in time, and better management will assure them that their loans will not be misused. In this regard, the application of generally accepted will assure the agency, that everything related to their loan will be clearly mentioned in the financial statements. These principles may help the company to record all the financial information according to a set pattern which will ultimately save time and recording costs. The saved expenses may be used in some other departments like marketing and related activities. This amount may even be used in the corporate social responsibility aspect so that social reputation of the company is also improved.

# **Reference**

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