Proceedings of the 3rd International Conference on Business and Policy Studies
DOI: 10.54254/2754-1169/76/20241683

A Financial Analysis of Capital Structure Based on HUAWEI

Zihan Xu[1,a,*]

[1]*College of Finance and Statistics, Hunan University, Changsha, 410006, China*
a. 202118110310@hnu.edu.cn
**corresponding author*

Abstract: This article investigates the optimization of asset structures across industries, using Huawei's asset composition as a paradigm. Through a detailed analysis employing metrics like debt ratio and equity multiplier, this paper aims to distill insights guiding companies in crafting optimal asset structures. Huawei's asset framework is scrutinized for valuable benchmarks, offering universal strategies or industry-tailored adaptations. By dissecting key financial indicators, it intends to unravel patterns indicative of financial health and efficiency in resource utilization. The focus on debt ratio and equity multiplier serves as a holistic approach, applicable across diverse sectors. Beyond Huawei's example, the article considers the variances among companies in different industries, proposing customized strategies to establish the most suitable asset structures. The objective is to provide practical recommendations for companies, akin to Huawei, navigating industry-specific challenges and financial goals. This article transcends a singular case study, evolving into a comprehensive guide for businesses seeking to strike an optimal balance in their asset composition, fostering adaptability across diverse industry landscapes.

Keywords: Capital Structure, HUAWEI, Financial Statements

1. Introduction

Companies in different industries: Firstly, let's analyze the characteristics of companies in different industries. This paper mainly divides the industries into three parts [1]. To begin with, let’s see companies in asset-heavy industries. These companies tend to have relatively long cycles. Their capital layout is also relatively intensive. Asset-heavy industries mainly include highly leveraged companies such as real estate companies and manufacturing companies, with debt ratios as high as 60% [2]. Take an example of the real estate companies, a large amount of initial investment is required, including land purchase, planning and design, construction, etc. In order to complete projects quickly, companies often choose to borrow money to raise funds. As a result, companies need to repay a large amount of debt in a short period of time, leading to the accumulation of debt. Moreover, real estate projects often have a long cycle, and it can take several years from land acquisition to delivery. During this period, companies need to continue to invest funds, including paying land costs, design fees, construction fees, marketing fees, etc. These costs often need to be paid through borrowing. At the same time, the time to recover housing payments is relatively late, and companies need to gradually recover their investment after the project is delivered. As a result, the company will need to bear a large amount of debt during the project development process, and the debt will naturally increase gradually. In China, real estate companies are greatly influenced by policies [3]. China's real estate industry implements a pre-sale system, and companies can collect house payments from home buyers through pre-sales before the houses are built. This part of the funds was used for the construction and operation of the project before completion, allowing real estate companies to use home buyers' funds for development, thereby increasing liabilities. In addition, in order to control the excessive rise in housing prices and prevent financial risks, the government will regulate the real estate industry [4]. These regulatory policies include limiting loan size and increasing down payment ratios, and so on, aiming to reduce the purchasing power of home buyers and thereby curb the rise in housing prices. However, these policies have also restricted financing channels for real estate companies, making it more difficult for them to raise funds [5]. In order to complete projects, companies may have to raise funds through private loans with high interest rates, further increasing liabilities. These are the reasons and mechanism of the high leverage ratio of asset-heavy industry companies like real estate companies.

Next, this paper will take a look at another two parts. Compared with asset-heavy industries, asset-light industries show different characteristics. Company cycles in asset-light industries are generally shorter. Typical representatives include retailing companies and so on. Companies in asset-light industries usually have lower leverage ratios, which are around 20%.

In addition to the above two industries, there is another typical industry, which is the technology and nursing industry. This kind of industry values the scientific research and development and implements sustainable development strategies. Their R&D investment generally accounts for a relatively high proportion, and they spend a large amount of money in this regard. Compared with the first two industries, the scientific research and nursing industries have relatively higher leverage ratios, approximately 50% to 60%.

2. M&M Theorem

This section will introduce the MM theorem. This theorem has three assumptions: (1) The company's total cash flow is not affected by the capital structure; (2) There are no transaction costs; (3) There are no arbitrage opportunities. If the above three assumptions are met, the company's total market value will not be affected by the capital structure. This assumption excludes the following situations: tax, bankruptcy costs, strategic effects-which means that competitors are likely to adjust their strategies based on the company's capital structure and debtor pressure on management [6].

3. Case Analysis of HUAWEI

After analyzing the characteristics of different industries, this paper will pay attention to a representative company, Huawei and introduce it. Huawei is a comprehensive company covering all three industries. This paper focuses on analyzing Huawei's financial statements.

The analysis of financial statements focuses on the various main activities of the entity, provides necessary information to users of the entity's financial statements, and reflects the specific characteristics of the entity's main activities. Evaluate the company's operating performance. Financial statements provide information about an entity's financial position, financial performance, and cash flows. and disclose the company’s future rewards and risks [7]. Monitor the execution of budgets, evaluate the performance of business managers, and design more reasonable and meaningful incentives.

From an entity's perspective, the analysis of financial statements mainly includes the following aspects: analyze the solvency of the entity; evaluate the equity structure to understand how the entity uses debt resources; evaluate the liquidity of the entity's assets, assess the financial status and evaluation of the entity Financial performance of the entity. In order to grasp the company's asset

DOI: 10.54254/2754-1169/76/20241683

allocation status and turnover; evaluate the company's profitability, and analyze the realization of the company's profit indicators and changes in profit levels in each year.

"To speed up the construction of a planning, budgeting, and accounting system centered on financial management, it must use product lines, regional departments, and representative offices as basic units to establish a planning, budgeting, and accounting system. The purpose is to provide regional departments, representative offices, and Combat services for product lines, rather than summarizing a financial statement for the headquarters." In 2007, Ren Zhengfei made a clear positioning on how to build an operation and management system through planning, budgeting, and accounting.

Before analyzing the company, let’s take a look at the situation of the related industry. In today's digital age, 5G, cloud, IoT and artificial intelligence are converging to create a world where everyone can be sensed, connected and intelligent. A series of major and far-reaching changes are taking place around the world: the "Wintel" alliance formed by Microsoft and Intel has collapsed. While Apple is rapidly becoming the world's largest technology company by market value, IBM is announcing its new Strategic Vision "Smart Planet". The company is the world's largest provider of information and communications infrastructure and smart terminals. Huawei is committed to bringing every member of society into this intelligent world where everything is connected. As a leading company serving more than 3 billion people in the industry, Huawei has become a benchmark company in my country's communications intelligence industry and has attracted much attention. Therefore, it needs to pay attention to long-term business development planning. Understand the history of digitalization and intelligence in the industry and promote the overall development of the enterprise.

3.1. Balance Sheet Analysis

First of all, let’s analyze Huawei’s balance sheet balance structure. According to different liquidity, the company's assets can be divided into current assets and non-current assets, and liabilities can be divided into current liabilities and non-current liabilities. If a company's long-term assets are supported by short-term liabilities, it will put a lot of pressure on the company's cash flow. There is even a risk that the financial circuit is broken, that is, the company's financial structure is a risk structure. On the contrary, when current assets are based on long-term debt, although the company's financial position is relatively stable, it will also increase the company's financial costs.

Comparing the structure of Huawei's current assets and current liabilities from 2019 to 2022, it can find that the company's balance sheet structure at the end of these five accounting periods is a stable structure. It can be seen from the data that Huawei's current liabilities are not used to support non-current assets, and the overall balance sheet structure is stable.

Then, this paper will analyze Huawei's asset trend changes and structural analysis. Except for a slight decrease in the absolute size of Huawei's current assets in 2019-2020, it has generally increased steadily. Looking at the relative size of Huawei's current assets at the end of each year from 2018 to 2022, Huawei's current assets accounted for 80% of total assets in 2018. By the end of 2022, the proportion of current assets in total assets has dropped to 73%. The absolute amount and relative proportion of a company's easily realizable assets are getting lower and lower, and companies have fewer and fewer assets that can be liquidated in the short term, which is not conducive to improving the company's short-term solvency.

Long-term assets are relatively difficult to realize, and most of them are special-purpose. As market conditions change, the products produced by the original long-term assets become less marketable and difficult to bring profits to the enterprise. As the saying goes, "the ship turns around in disaster" Once this happens, it will have a huge impact on the company's continued operations [8]. The increase in the proportion of non-current assets has increased the exit risk, technology risk, operating risk and mismatch risk of enterprises. The increase in the proportion of Huawei's non-current assets in total assets is not conducive to reducing the above risks.

After this, it will see the analysis of specific items of current assets: (1) money fund analysis. By maintaining an appropriate level of foreign exchange reserves, companies can enhance their financial capabilities and reduce the risk of potential losses. It can be seen that Huawei's absolute cash balance has significantly increased. The main reason for the continuous high growth of cash balance is the steady expansion of business scale. The proportion of monetary funds held by Huawei in total assets is basically in a declining state. This is not conducive to enterprises resisting the financial risks they may face in the short term. In 2020, Huawei's monetary funds and the proportion of monetary funds in total assets significantly decreased, mainly due to the suppression of the United States, the impact of the epidemic, and weakened demand for 5G construction. (2) From 8 to 20 years ago, Huawei's accounts receivable and the proportion of accounts receivable in total assets continued to decline. In 2020, accounts receivable reached its lowest point, mainly due to the suppression of the United States, fierce competition in the commercial market, and the impact of the epidemic. However, in 2021, there was a significant increase. In future business activities, if downstream customers request settlement in a non-cash manner, the company can request the trading party to settle promissory notes to avoid potential loss risks. At the end of each year from 2018 to 2021, the absolute amount of accounts receivable for enterprises continued to decline. This was mainly due to fierce competition in the commercial market in 2018, and Huawei reduced inventory to reduce inventory risk and management expenses. (3) The proportion of accounts receivable in total assets is also continuously decreasing, and the recovery of accounts receivable is uncertain. If downstream customers have poor business conditions, they may not be able to make payments, causing losses to the enterprise. In the context of macroeconomic conditions, there are frequent reports of debt defaults, and many companies have a very tight funding chain. Huawei's industry competitiveness has declined. (4) Huawei saw a continuous increase in the absolute amount of prepaid accounts at the end of each year from 2018 to 2020. The absolute amount of prepaid accounts in 2020 was three times that of prepaid accounts in 2018, and it rapidly declined in 2021. The proportion of prepaid accounts in assets has significantly decreased, from 0.43% to 0.0008%. Advance payment is a prepayment made by a company to a previous supplier in cash or cash equivalents in accordance with the terms of a procurement contract. After consulting information, it was found that Huawei's prepaid accounts are mainly paid to companies such as Changzhou Fengsheng Optoelectronic Technology Co., Ltd., Dunhao, and Foxconn.

Huawei's fixed assets mainly include mechanical equipment, transportation equipment, motors and instruments, and others. It can be seen that the absolute scale of Huawei's fixed assets has significantly decreased in the past four years. At the end of 2018, the proportion of fixed assets in total assets was 8.59%. By the end of 2021, the proportion of fixed assets in assets had decreased to 0.05%, and the proportion of fixed assets in total assets had significantly decreased. The main reason for the decline is that as an electronic information and communication equipment manufacturing company, Huawei does not need to invest a large amount of fixed assets in its own development or external expansion of business [9]. Huawei's intangible assets at most refer to its excellent resources and innovative achievements in intellectual property, technology research and development, network construction, and other aspects. Also, it can be seen that the absolute scale of Huawei's intangible assets has continued to decline significantly in the past four years. At the end of 2018, the proportion of intangible assets in total assets was 2.18%, and by the end of 2021, the proportion of intangible assets in fixed assets had decreased to 0.29%.

Debt is the current debt generated by past transactions or events of a company, which is expected to result in the outflow of financial income from the company. Debt financing is a financing method for enterprises other than equity financing. The use of debt financing by companies can generate tax savings and provide leverage. However, if the debt structure is unreasonable, it can bring significant financial risks to the company, and in severe cases, even lead to bankruptcy.

Huawei's total liabilities at the end of 2018 were 432727.267 million yuan, and by the end of 2021, Huawei's total liabilities had reached 568282.193 million yuan. The overall scale of liabilities has increased nearly 1.3 times in four years, and total assets have increased from 665789.94 million yuan to 982836.385 million yuan, an increase of approximately 1.4 times. The growth rate of total liabilities is slightly lower than that of total assets.

3.2. Income Statement Analysis

The items in the income statement reflect specific factors such as income, expenses, and profits. From the perspective of reflecting changes in the company's working capital, it is a report that reflects the dynamic performance of the company's working capital, mainly providing customers with information on the company's operating results.

Huawei's operating revenue reached 882841.724 million yuan in 2020, which is the highest compared to other years. In 2021, there was a first decline in operating revenue, with a decline of over 28%. The reason is the suppression by the United States, the impact of the epidemic, and the weakening demand for 5G construction. However, at the same time, the increase in net profit was also the largest in recent years, with an increase of over 75%. The results released by Huawei indicate that it achieved net revenue in 2021, mainly due to the sales of some businesses, improved operational quality, and optimized the company's product structure. One of the biggest factors is that in 2020, Honor's phone was sold to Shenzhen Zhixin, and in 2021, X86's business was sold to Super Fusion. Including this money, Huawei's net profit is 8.4 billion yuan.

Through analyzing the financial data of Huawei, it can draw the following conclusions. The problems of financial management in technology limited companies in recent years have mainly focused on two aspects: first, the application of accounting standards; The second is the imperfect internal financial management system of the company. In terms of the application of accounting standards, Huawei has been investigated by the US Securities and Exchange Commission (SEC) for violating US accounting standards. In 2021, Huawei CFO Meng Wanzhou was arrested in Canada, also related to the company's violation of US accounting standards. In addition, Huawei has also been accused of accounting fraud in its 2020 financial reports. In terms of internal financial management system, Huawei has been criticized for its non-standard internal financial management. In 2021, Huawei was exposed to have a "reward plan" that encourages employees to violate company regulations, while the company's internal audit department also had issues with improper management. (1) The investment in risk control is insufficient. Huawei Technology Co., Ltd. has an imperfect fundraising model, unreasonable allocation of share rights within the company, and has not mastered direct financing methods. In terms of external fundraising, due to the limitations of the type of enterprise, it faces greater risks and its own credit value is low, which makes it difficult to gain the trust of financial organizations. (2) The financial support system is not yet perfect. When Huawei Technology Co., Ltd. developed, it did not have a good financial service system to support it, and the company's external financing channels could not effectively play a role. The impact of external financing channels can lead to higher financing costs. (3) The lack of scientific financial decision-making in Huawei's management model is a high degree of unity between ownership and management rights. The investors of the enterprise are also the operators, and they tend to have one voice in the company's strategy and major decisions, without a complete set of institutional standards to regulate them. At the same time, there is a lack of proper understanding and research on financial management, with a focus on business rather than finance, resulting in financial management not being able to participate autonomously in the decision-making and management process of enterprises, leading to the inability of important financial tools in financial management to play a role.

DOI: 10.54254/2754-1169/76/20241683

(4) The inherent limitations of external financing were during an important period of development for Huawei Technology Co., Ltd. From the perspective of retained earnings financing, the company's lack of funds was quite severe. From the analysis of the company's debt financing situation, there are relatively few external financing channels, and banks tend to provide credit to state-owned enterprises [10].

4. Conclusion

Overall, although the financial problems of Huawei Technology Co., Ltd. are inevitable, the company should strengthen the construction of internal financial management systems, improve financial transparency, comply with international accounting standards, and ensure the stable and healthy development of the company. The service transformation strategy guides investment strategy. Huawei should develop a correct investment strategy, attach importance to the management of debt and creditor's rights, establish a system for accounts receivable collection and overdue payment collection, and pay attention to the issue of credit sales and management of accounts receivable. Optimizing the allocation of financial resources first requires improving operational management efficiency and enhancing the level of managers. Excellent managers can develop good plans for the enterprise, have a long-term vision and comprehensive thinking, and can effectively utilize resources. Strengthen fund operation management and financial control. Based on Huawei's cash flow situation, in the cash management process, it is necessary to prepare a cash budget, determine the optimal cash holding amount, accelerate cash inflows, slow down cash outflows, and strive to synchronize cash inflows and outflows to minimize cash holdings and fully improve the efficiency of cash utilization. Clearly and clearly define property rights and establish a reasonable corporate property rights system. Establish and improve a modern governance system for shareholders, board of directors, supervisory board, and management team.

References

[1] *Smith, A. (1759b). The theory of moral sentiments. In Oxford University Press eBooks.*

[2] *Andersson, S. (2000). The Internationalization of the Firm from an Entrepreneurial Perspective. International Studies of Management and Organization, 30(1), 63–92.*

[3] *Annavarjula, M., & Beldona, S. (2000). Multinationality-Performance Relationship: A Review and Reconceptualization. International Journal of Organizational Analysis, 8(1), 48–67.*

[4] *Dunning, T. H. (1971). Gaussian basis functions for use in molecular calculations. III. Contraction of (10s6p) atomic basis sets for the First-Row atoms. Journal of Chemical Physics, 55(2), 716–723.*

[5] *Hitt, M. A., Hoskisson, R. E., & Kim, H. (1997). International Diversification: Effects on Innovation and Firm Performance in Product-Diversified Firms. The Academy of Management Journal, 40(4), 767–798.*

[6] *Johanson, J., & Vahlne, J. (1977). The internationalization Process of the Firm—A model of knowledge development and increasing foreign market commitments. Journal of International Business Studies, 8(1), 23–32.*

[7] *Johanson, J., & Wiedersheim-Paul, F. (1975). The Internationalization of the Firm ? Four Swedish Cases. Journal of Management Studies, 12(3), 305–323.*

[8] *Lane, H., & Beamish, P. (1990). Cross-Cultural Cooperative Behavior in Joint Ventures in LDCs. International Review, 30, 87-102.*

[9] *Osborn, R. N., & Baughn, C. C. (1990). Forms Of Interorganizational Governance for Multinational Alliances. Academy of Management Journal, 33(3), 503–519.*

[10] *Piercy, N. (1981). Export strategy:Concentration on key markets vs.market spreading.Journal of International Marketing,1(1): 56-67.*