## Conceptual Framework of Financial Performance Analysis

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3.1 Introduction

Financial efficiency is the snapshot of a position of concern and ability to withstand the ever changing environment. It is the blueprint of the financial afire of the concern and reveals how a business has prospered under the leadership of a management personnel. In fact it can be said that financial efficiency is the medium of evaluation of management efficiency. The overall object of business is to earn satisfactory returns on the funds invest in it. Consistent with maintaining a sound financial position, an evaluation of such performance is done in order to measure the efficiency of operations or profitability of the organization and to appraise the financial strength as compared with a similarly situated concern.

Thus, financial efficiency is generally directed towards evaluating the liquidity, stability and profitability of a concern which put together symbolizes the financial efficiency of a concern.

3.2 The Concept of Performance

The word ‘Performance’ means ‘the performing of an activity, keeping, in view the achievement made by it’. In other words, ‘Performance’ means ‘the role Played by an arrangement keeping in view the achievement made by it’. In the context of the banks, it takes into account the way of their progress.

The opinion of Robert Albans about performance is “The word ‘performance’ is used to mean the efforts extended to achieve the targets efficiently and effectively. The achievement of targets involves the integrated use of human, financial and natural resources.”

According to Erich L. Kohlar, “The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time; often with reference to past or projected costs efficiency, management responsibility or accountability or the like.”
On the basis of the above definitions, it can be said that the word ‘Performance’ not only refers to the presentation of something but it also exhibits the quality and results achieved by the management of an enterprise. It takes into account the accomplishment of objectives and goals set for an enterprise. Keeping in view the comparison of the present success with the past. However in the context of the present study, it covers financial, cost, personnel and social aspects. Thus we can say that the overall conclusion of the activities of an enterprise is called ‘Performance’.

3.3 The Measurement of Performance

According to P.C. Tripathi, Measurement May be defined as “The assignment of numerals to characteristics of objects, persons, states or events accounting to rules. What is measured is not the object, person, state or event itself but some characteristics of it.

When objects are counted, for example, we do not measure the object itself but only it’s characteristic of being present. We never measure people, only their age, height, weight or some other characteristics.”

According to Michael Mascon “Performance is dependent on effort, abilities, traits and the individual’s perception of his role.”

While measuring the performance of a firm or an enterprise we need a measuring unit. Human aims and beliefs are mostly realized through the establishment of diverse kinds of associations. All associations were established for fulfillment of some goals and objectives. Thus association needs performance measurement to find out as to how much is organization has achieved by its course of action for its targets. The financial appraisal is a vital unit to measure the performance of firms. Therefore, financial statements are prepared to serve the objective.

According to Eldon S. Hendriksen, “The primary focus of financial reporting is information about an enterprise’s performance provided by measures of earnings and its components.”
Erich A. Helfert rightly remarks, “The measurement of business performance is more complex and difficult. Since it must deal with the effectiveness with which capital is employed, the efficiency and profitability of operations, and the value and safety of various claims against the business.”

In any business enterprise, accounting provides financial data through income statements, balance sheet and sources and uses of funds statements.

According to Stanley B., “The financial manager must know how to interpret and use these statements in the allocation of the firm’s financial resources to generate the best return possible in the long run. Finance is the link that integrates the economical theory with the numbers of Accounting.”

Measurement of performance through the financial statement analysis provides a good knowledge about the behavior of financial variables for measuring the performance of different units in the industry and to indicate the trend of improvement or deterioration in the organizations.

3.4 Concept of Efficiency

Efficiency is closely related to surety of the working system of a company as a whole. According to Sudha Nigam “Efficiency is a technique to evaluate past, current and projected performance of a concern.” It is a powerful applied tool to examine, to measure to interpret and to weigh critically and draw outputs.

Efficiency is done by different specialist who examines the specific problem with their company. Efficiency can be divided into two parts (1) Internal (2) External.

According to Pitt Francis “Internal efficiency of the company not only making some of having adequate human, physical and financial resources but seeing that they are optimally employed.”

Thus, the concept of efficiency means to evaluation and performance of a concern included in the appraisal. The word efficiency as defined by the oxford dictionary state that “Efficiency is the accomplishment of or the ability to accomplish a job with
minimum expenditure of time and effort. It refers to the internal process that leads to output. It focuses on the means to achieve the desired end. As expressed by Peter Drucker “Doing the things the right way is efficiency.” This denotes the fulfillment of the objective with minimum sacrifice of the available scare resource.

3.5 The Measurement of Efficiency

According to P. C. Tripathi “Measurement may be defined as “The assignment of numerals to characteristics of objects, persons, states or events according to rules. What is measured is not the object, person, state or event itself but some characteristics of it. When objects are counted, for example, we do not measure the object itself but only it’s characteristic of being present. We never measure people, only their ate, height, weight or some other characteristics.”

According to Michael Mascon “Performance is dependent on efforts, abilities, traits and the individual’s perception of his role.”

While measuring the performance efficiency of a firm or an enterprise we need measuring units. Human aims and beliefs are realized through the establishment of diverse kinds of associations. All associations were established for fulfillment of some goals and objectives. Thus association needs efficiency measurement to find out as to how much is organization has achieved by it course of action for its targets. The financial efficiency is a vital unit to measure the efficiency of firms. Therefore financial statement is prepared to serve the objective.

Erich A. Helfert rightly remarks, “The measurement of business efficiency is more complex and difficult. Since it must deal with the effectiveness with which capital is employed, the efficiency and profitability of operations and the value and safety of various claims against the business.”

According to Eldon S. Hendriksen “The primary focus of financial reporting is information about an enterprise’s performance provided by measure of earnings and its components.”
The main object of preparing financial statement is to show the result achieved by an enterprise through its operations the revenue and the expenditure accrued to fulfill that revenues and the actual financial position for the particular period on a particular date. In order to analyze financial statement properly, users must have a basic understanding of the concept and principles underlying their preparation. Without such an understanding users will not recognize the limits of financial statements. In any business enterprise, accounting provides financial data through income statements, balance sheet and sources and uses of fund statements.

According to sanley B. “The financial manager must know how to interpret and use these Statements in the allocation of the firm’s financial resources to generate the best return possible in the long run. Finance is the link that integrates the economical theory with the numbers of accounting.”

Measurement of efficiency through the financial statement analysis provides a good knowledge about the behavior of financial variables for measuring the efficiency of different units in the industry and to indicate the trend of improvement or deterioration in organisation.

3.6 Objectives of Financial Efficiency

Financial efficiency is a technique to evaluate past, current and projected performance of a concern. Generally financial efficiency is concerned with the analysis of financial statements. This analysis can be applied to any kind of detailed information of financial data. The main purpose of this analysis is to evaluate past performance for earnings, ability to pay interest and debt on maturity and profitability of a concern.

R.F. Salmanson, R.H. Hermanson and J.D. Ewards have stated that, “a modern business firm has many objectives or goals including some social objectives such as providing job opportunities and comfortable working conditions for its employees.

According to S.K. Das “The Primary objectives of efficiency of financial statements are to determine the measure of efficiency of operations or the profitability from its income
statement and to appraise financial strength as compared with similarly situated concern.”

A study in order to be useful should be object oriented. Objectives work as a compass for an analyst. Thus efficiency of financial statements should always be turned to the objectives. In the words of R.N. Anthony “The overall objectives of a business return on the funds invested in it, consistent with maintaining a sound financial position.

3.7 Areas of Efficiency

There are areas where the efficiency can be improved by effective assessment of performed by a business enterprise in different areas of operations. The areas of operations may be termed as the area of efficiency.

1. Service Production and Productivity Efficiency

Service Production is the most important area of the efficiency, and productivity is the systematic analysis for evaluating the service production function. The service production efficiency of insurance public sector company can be compared for different years with the one another competitive public sector insurance companies. The analysis of capacity utilization and component part analysis of services production can significantly prove the service production efficiency of insurance company as a whole.

2. Profitability Efficiency

Profitability is the ability to earn profit. The insurance company management is vitally interested in profit as it is often used as efficiency measure. Measurement of profitability is the overall measurement of efficiency. Profit is also important to financial institutions, bankers and creditors. Profitability efficiency can be made by computing and interpreting various profitability ratios.
3. Liquidity Efficiency

By checking the fluctuations most probably in current assets, the researcher can take the estimate of liquidity efficiency.

4. Working Capital Efficiency

Generally working capital is said to be excess of current assets over current liabilities. It is used for regular business costing of loans and advances, payment of wages, direct and indirect expenses, investments, credit granted to customers and cash on hand. It is lifeblood of each insurance company. As soon as the heart gets blood, it circulates the same in the body. In the same manner working capital funds are obtained and circulated in insurance operations. As and when this circulation stops, the insurance business becomes lifeless. So the working capital has an important place in the area of efficiency.

5. Fixed Assets Efficiency

According to foutke, Roy A. Some part of the capital of every master artificer or manufacturer must be fixed in the instrument of his trade.” Usually a firm does not deal in fixed assets, so they are not trading assets. They are also not acquired for sale. Amount invested in these assets is realized gradually from every unit of sales made during the serviceable life of the assets. Analysis of fixed assets structure average annual growth of fixed assets, impact of gross block on sales and operating profit margin and efficiency in the use of fixed assets may depict the efficiency of fixed assets. Since the depreciation is directly related to fixed assets. The study of depreciation and the depreciation provision policy in using fixed assets can also be useful.

6. Fund Flow Efficiency and Cash Flow Efficiency

Here a fund-flow statement of insurance company is prepared to check the receipt usage of fund and cash flow statement of insurance company is prepared to check the receipt and usage of cash.
7. Social Efficiency

The value of all the resource concerned with the insurance industry is called social efficiency. They may be men, material, money and machines. All these resources which are to be used for the welfare of society and insurance industry are included to evaluate social efficiency.

3.8 The Need and Importance of Appraisal of Efficiency

The need and importance of appraisal of efficiency rise from the viewpoint of different parties, which are actively interested in the affairs of the general insurance public sector companies. These parties are as below:

(1) Management

According to Erich A. Heifert, “Managers are responsible for efficiency, current and long term operations and effective development of capital and other resources in the process.” Appraisal of efficiency may help management in evaluating the effectiveness of its own plans and policies. The managements can measure the effectiveness of its own plans and policies, determine the advisability of adopting new policies and procedures and document to owners as a result of their managerial efforts by doing appraisal of efficiency.

(2) Employees and Trade Unions

Employees of the general insurance companies are interested in profits and the financial position of a company. The employees measure the efficiency of the general insurance company with the satisfactory profit margin and adequate cash flow. The employees can compare the past efficiency and the present efficiency of company by appraisal of efficiency. Even trade union of companies use appraisal of efficiency of company for demanding increase in wages and facilities.
(3) Investors

Investors are the real investor of any enterprise. In case of insurance industry, the investors can know profitability, productivity and overall efficiency of the company by studying appraisal of efficiency.

(4) Policy Holders

The policy holders, wanted business with general insurance company, general appraise the efficiency of a company before taking insurance. The policy holders are interested in good services as well as monetary benefits offered by general insurance companies, cash flow and liquidity of insurance companies. The can know these each aspect by referring appraisal of efficiency.

(5) Government

By studying the appraisal of general insurance companies the government can assess the growth of industries and economy. Moreover the government can take decision about tax structure and incentives for general insurance industry.

(6) Society

In the society, there are various agencies like media, stock exchanges, economists, tax who are interested in appraisal of efficiency of general insurance industry. The societies expect security of their beloved property which is provided by general insurance company mainly. The society also wishes to survive against risk of natural and accidental disaster by getting help from general insurance company. The society at large also expects to know about the social efficiency such as environmental obligations, employment avenues and social welfare etc.

3.9 The Role of Financial Efficiency in Planning, Control & Decision Making

Financial efficiency plays an important role in providing so many useful information to the insurance management as it is inevitably needed for planning, control and decision
making. Decisions always relate to what has to be done immediately, in near future and in the long run. For this, the insurance management requires various types of information, both qualitative and quantitative. Financial efficiency has taken on increasingly the task of providing the quantative information.

This term also includes provision of such information as will enable the management to exercise control over the day to day operations with a view to ensuring maximum efficiency and adherence to the plans of the insurance management. This control is different from control over property and assets, as it looks at things from such angles.

(a) That the work which had to be done has to be done without loss of time.

(b) That the cost incurred in doing the work is not more and is within the estimated limits.

Also for planning, control and decision making of capital projects, such as expansion and diversification, financial efficiency provides and examines a great deal of information.

3.10 Objective of Financial Performance Appraisal

Performance appraisal involves a broad area of coverage. The perspective throughout is on the effective management of company resources. Performance appraisal can be done through a careful and critical analysis of the financial statement of an enterprise. Usually the financial statement of a business concern comprises two statements: balance sheet or position statement and profit and loss account or income statement. However, in big concerns two more statements are prepared. They are profit and loss appropriation account and fund flow statement. The overall performance of a business cannot be judged without a systemic analysis and interpretation of its financial statements. The advantages of such an analysis are as follows.

**Objectives of the performance appraisal**

(i) To find out the financial stability of a business concern

(ii) To assess its earning capacity

(iii) To estimate and evaluate its stock and fixed assets.

(iv) To assess its capacity and ability to repay short and long term loans

(v) To estimate and examine the possibilities of its future growth
(vi) To estimate the administrative efficiency of its management

Performance appraisal is a close and a critical study of various measures observed in the operation of Business Organization. The concept of human body is similar to the concept and case of business organization. Human body requires medical checkup and examination for maintaining fitness of bodies, similarly the performance of a business organization has got to be assessed periodically.

One must define the view points to be taken, the objectives of the analysis and possible Standard Comparison". Business Organization have the "Balance Sheet" and the "Profit and Loss Account" by the statements of change in financial position value added statements are also prepared for annual reports. They may be considered as additional financial statements. The data embodied in financial statements are rearranged in order to facilitate the appraisal of performance. The financial figures are approximated to the nearest rupee to simplify the process of appraisal.

However, no single attempt can give firm results of appraising the performance of business organization. Business conditions differ according to location, type of facilities, products and services, plant capacity, capital structure, accounting policies, caliber of management and levels of efficiency. Such conditions of business organizations have become more complicated in the event of multi-product and multi business organizations. All these differences are part and parcel at the time of appraising the performance of a business organization.

3.11 Concept of Financial Structure

Financial Structure is a business as consisting three elements for assets, liabilities and capital. The financial structure provides an insight into the various types of sources tapped to finance the total assets employed in a business enterprise that part of financial which represents long-term sources is known as “capital structure.” This term refers to make up of long–term funds as represented by the equity share capital, preference share capital and long-term debt. To circumscribe the real area of the term “Capital structure.” It may be necessary to distinguish it from term “assets structure,” the assets structure
refers to make-up of total assets as represented by fixed assets and current assets.

Since the balance sheet is a detailed form of fundamental or structure equation. It sets forth the financial structure of an enterprise. It states the nature and amount of each of the various assets of the liabilities and of the property interest of the owner. Stating the nature of the assets, liabilities and capital is not difficult as their amount.

The capital structure is used to represent the proportionate relationship between the various long-term forms of financing, such as debentures, long-term debt, Preference capital and equity capital reserve and surplus. The term capital structure is frequently used to indicate the long-term sources of funds employed in a business enterprise.

In other words, it can be said that it represents permanent financing of the concern. This is usually measured by subtracting current liabilities from total assets. Thus, capital structure, general reserve, preference share and long–term debts.

**3.12 Types of Financial Performance Analysis**

Financial performance analysis can be classified into different categories on the basis of material used and modus operandi as under:

**Chart No. – 3.1 Classification of Financial Performance Analysis**
i). Material used

On the basis of material used financial performance can be analyzed in following two ways:

1. External analysis

This analysis is undertaken by the outsiders of the business namely investors, credit agencies, government agencies, and other creditors who have no access to the internal records of the company. They mainly use published financial statements for the analysis and as it serves limited purposes.

2. Internal analysis

This analysis is undertaken by the persons namely executives and employees of the organization or by the officers appointed by government or court who have access to the books of account and other information related to the business.

ii) Modus operandi

On the basis of modus operandi financial performance can be analyze in the following two ways:

1. Horizontal Analysis

In this type of analysis financial statements for a number of years are reviewed and analyzed. The current year’s figures are compared with the standard or base year and changes are shown usually in the form of percentage. This analysis helps the management to have an insight into levels and areas of strength and weaknesses. This analysis is also called Dynamic Analysis as it based on data from various years.

2. Vertical Analysis

In this type of Analysis study is made of quantitative relationship of the various items of financial statements on a particular date. This analysis is useful in comparing the
performance of several companies in the same group, or divisions or departments in the same company. This analysis is not much helpful in proper analysis of firm’s financial position because it depends on the data for one period. This analysis is also called Static Analysis as it based on data from one date or for one accounting period.

### 3.13 Techniques & Tools to measure financial performance

There are various tools available to judge the financial performance of the firm. They include the following.

1. **Financial Ratio Analysis**

The Financial Ratio Analysis is considered to be the most powerful tool of financial analysis. In simple language ratio means relationship between two or more things. It is also said that a ratio is the indicated quotient of two mathematical expressions. It is observed that the absolute financial figures published in the annual report do not give any clear picture about the performance of a firm.

The ratio analysis also helps to summarize the large quantities of financial data and to make qualitative judgment about the firm’s financial performance. There are various liquidity ratios which are quantitative in nature but are helpful to make qualitative judgment about the firm. The financial ratios involve useful information about the analysis of the firm. However, standalone ratio of one firm alone may not be useful to evaluate the firm’s performance. Therefore, ratio should ideally be compared with some standard which may consist of the following.

i) **Past Ratios**

Past ratios are the ratios which are calculated from the financial statements of previous years.
ii) Competitors’ Ratios

The ratios of some same size and industry representative firm, which can be considered as the progressive and successful competitor can be useful for comparison. However, they should be compared within a similar timeframe.

iii) Industry Ratio

There are some ratios which are common at industry level. However, they may be compared at the firm level – in reference to which the industry belongs.

iv) Projected Ratios

Whenever, a firm approaches to any long term finance provider, they have to give financial projections, which are based on some ratios.

Above points are normally refereed for inter-firm or firm v/s industry comparison. However, in all circumstances it is difficult find the exact competitor company for comparison because of several reasons. The ratio analysis can further be used in the following context:

a. Time Series Analysis

This is a very easy way to evaluate the performance of a firm. In this, the current year’s financial ratios are compared over a period of time. This is an indication of direction of the firm’s direction of change. Here, the role of analyst is also becoming important. It should be noted that the analyst should not only stick to mathematical aspect of the ratio. They should go into root cause and try to analyze the reasons behind changing trend of ratios.

b. Cross Sectional Analysis / Inter-firm analysis

When the financial ratio of one firm is compared with some selected firms in the same industry, at the same point of time, it is known as Cross Sectional Analysis or Inter-firm analysis. In many cases, comparison of firm’s performance with carefully selected firms
from the industry is more beneficial. It may indicate the firm’s strengths or weaknesses in terms of operating leverage or financial leverage.

c. Industry Analysis

In this type of analysis, the ratio of one firm is compared with the average ratios of industry – of which a firm is a member. This type of analysis is known as Industry Analysis. It is well accepted fact that each industry has its unique characteristics, which will have impact on the financial and operating relationships of the firm. But in many cases, it is difficult to get the actual ratios of the industry because of various reasons.

d. Proforma Analysis

In many cases, future - projected ratios are used as the standard of comparison. The future ratios are normally used in the Financial Projections which are also popularly known as Proforma Ratios. The comparison of firm’s projected v/s actual ratio will indicate the relative position of the firm. Mainly it will also indicate the operational or financial leverage position of the firm – when it started the project and actual position when the project is completed or half way.

2. DuPont Analysis

According to the Du-pont analysis, RONA (or ROCE) is an important tool for judging the operating financial performance. It is an indication of the earning power of the firm. RONA is calculated as under:

\[
\text{RONA} = \frac{\text{EBIT}}{\text{NA}} \times \frac{\text{Sales}}{\text{Sales}} \times \frac{\text{GP}}{\text{GP}} \times \frac{\text{EBIT}}{\text{EBIT}}
\]

Where: RONA = Return on Net Assets
EBIT = Earnings before Interest and Tax
GP = Gross Profit
NA = Net Assets

It is observed that most of the firms would like to improve their RONA. However, in this competitive world, RONA is always under pressure. Hence, firms have to balance
between the Asset Turnover and Gross profit Margin. Many firms adopt various ways to increase the Gross Profit Margin some firms resort to vertical integration for cost reduction also.

A firm can convert impressive RONA into an impressive ROE through financial efficiency. It is observed that ROE us certainly affected by the Financial leverage and combination of debt and equity. Therefore, ROE is a product of RONA and financial leverage ratios which reflect the operating efficiency.

Therefore, ROE = Operating Performance X Leverage Factor.  

The Du-pont chart can also be indicated with the help of the following diagramme.

**Chart no. 3.2 The Du-pont**

Return on Equity

Return on Net

Assets Financial Leverage (Bal. Sheet) Financial Leverage (Income)

Profit Margin

Assets Turnover

Therefore, the combined effect of the du-pont chart can be explained with the following.

\[
\text{ROE} = \frac{\text{Sales} \times \text{GP} \times \text{EBIT} \times \text{PAT} \times \text{NA}}{\text{NA} \times \text{Sales} \times \text{GP} \times \text{EBIT} \times \text{NW}}
\]

As discussed above, ROE when it is multiplied by retention ratio gives growth.

**3. Comparative Statement Analysis**

Comparative Statement Analysis is one of the methods to trace periodic change in the financial performance of a firm. The changes over the period are described by way of Increase of Decrease in income statement and balance sheet. The changes are normally of two types:

i) Aggregate Changes

ii) Proportional Changes
4. Time Series Analysis or Trend Analysis

The Time Series Analysis or Trend Analysis indicates of ratio indicates the direction of changes. The trend analysis is advocated to be studied in light of the following two factors.

i) The rate of fixed expansion or secular trend in the growth of the business and

ii) The general price level.

Any increase sales statement may be because of two reasons, one may be the increase in volume of business and another is the variation in prices of the goods/services.

For trend analysis, the use of index number is generally advocated. The procedure followed is to assign the number 100 to the items of each base year and to calculate percentage changes in each item of the other years in relation to the base year.

5. Inter-Firm Analysis

A firm would like to know its financial standing vis-à-vis its major competitors and the industry group. Analysis of financial performance of all firms in an industry and their comparison at a given point of time is referred to the Cross Section Analysis or Inter-firm analysis. To ascertain the relative financial standing of a firm, its financial ratios are compared either with its immediate competitors or with the industry average.  

3.14 Areas of Performance

There are areas where the performance can be improved by effective assessment of various activities performed by a business enterprise in different areas of operations. The areas of operations may be termed as the areas of performance. The important areas are as follows:-

(i) Service Production and Productivity Performance

Service Production is the most important area of performance, and the productivity is the systematic analysis for evaluating the service production function. The service production data can be performed as compared to other competitive banking companies of the banking industry. The service production performance of the banking industry can be
compared for different years with the competitive industries. The analysis of capacity utilization and component part analysis of service production can significantly prove the service production performance of a banking company as a whole.

(ii) Profitability Performance

Profitability is the ability of an enterprise to earn profits. The bank management is vitally interested in profit as it is often used as performance measure. Measurement of profitability is the overall measurement of performance. Profit is also important to financial institutions, bankers and creditors. Moreover, even a layman also assesses the performance of a business enterprise by its ability to earn profit. Profitability performance can be made by computing and interpreting various profitability ratios.

(iii) Liquidity Performance

By checking the fluctuations most probably in current assets, the researcher can take the estimate of liquidity performance.

(iv) Working Capital Performance

Generally working capital is said to be the excess of current assets over current liabilities. It is used for regular business operations consisting of loans and advances, Payment of wages, direct and indirect expenses, investments, credit granted to customers and cash on hand. It is lifeblood of each bank. As soon as the heart gets blood, it circulates the same in the body. In the same manner working capital funds are obtained and circulated in banking operations. As and when this circulation stops, the banking business becomes lifeless. So we can say that the working capital has an important place in the area of performance, hence working capital performance indicates the adequacy of working capital in the bank and the efficiency as regards utilization of working capital. Analysis of working capital statements and various ratios of its kind may depict required information for the purpose.
(v) Fixed Assets Performance

According to Foulke, Roy A., “Some part of the capital of every master artificer or manufacturer must be fixed in the instrument of his trade.” Usually a firm does not deal in fixed assets, so they are not trading assets. They are also not acquired for sale. The amount invested in these assets is realized gradually from every unit of sales made during the serviceable life of the assets. Analysis of fixed assets structure, average annual growth of fixed assets, and impact of gross block on sales and operating profit margin and efficiency in the use of fixed assets may depict the performance of fixed assets. Since the depreciation is directly related to fixed assets, the study of depreciation and the depreciation provision policy in using fixed assets can also be useful. As fixed assets in nature are long-term tangible assets, therefore, they should basically be financed through long-term sources. In this respect, the ratio of fixed assets to net worth can be calculated to study financing of fixed assets. This ratio is very important as it shows that owners have provided enough funds to finance fixed assets.

(vi) Fund-flow performance

Here a fund-flow statement of bank is prepared to check the receipt & usage of fund.

(vii) Social Performance

The value of all the resources concerned with the banking industry is called social performance. They may be men, material, money and machines. All these resources which are to be used for the welfare of society and banking industry are included to evaluate social performance.

The social performance of any bank can be evaluated by considering different parties like government, depositors, financial institutions, investors, account holders and employees. All these parties are members of the society. Some important accounting ratios can be helpful to know the contribution made by the banks to the society.
3.16 Evaluation, Tools And Techniques of Financial Statement Analysis

A study of liquidity, productivity and financial efficiency through profitability is made by using the following tools and techniques Analysis of financial statement reveals the underlying significance of item composed in them. Analysis breaks down the complex set of facts of figures into simple elements. Interpretation is the next step. It consists in explaining the real significance of this statement. The analysis consist of the study of inter relationship between various item comprised in financial statement to determine whether the earning and the financial position of the company are satisfactory. A number of devices are used in the analysis of financial statement, some of which are as follow:

1. Comparative Statement Analysis

When financial statements of a few years are presented columnar form, it indicated the trend of changes taking place in business. The methods presenting both financial statement in columnar form and judging the trend of profitability and financial condition of business is known as comparative financial statement analysis. The methods of comparative statement are used to indicate the changes the current year’s figures as compare to past year figures. It may also be presented in manner that will show the percentages of various figures with some significant item. The various items of Profit and loss account and Balance sheet may be presented side by side which will show the trend of increasing or decreasing expensed of income and increasing or decreasing assets or liabilities. Statement prepared in a form reflecting financial data for two or more periods are known as comparative statements.

The data must first be properly set before comparison in the preparation of comparative financial statement uniformity is essential otherwise comparison will be vitiated. Comparative financial statement is very useful to the analyst because they contain not only the data appearing in a single statement but also information necessary for the study of financial and operating trends over a period of a year. They indicate the direction of the movement in respect of financial position and operating results. Comparison of
absolute figures has no significance if the scale of operations of one company is much different from that of others.

A) Comparative Balance-Sheet:

Increase and decrease in various assets and liabilities as well as in proprietor’s equity or capital brought about by the conduct of a business can be observed by a comparison of balance sheets at the beginning and end of the period. Such observation often yield considerable information, which is of value informing an opinion regarding the progress of the enterprise and in order to facilitate comparison a simple device known as the “comparative balance Sheet” may be used.

B) Comparative Income Statement:

As income statement shows the net profit or net loss resulting from the operations of a business for designated period of time. A comparative income statement shows the operating result for a number of accounting periods so that changes in absolute data from one period to another may be started in terms of money and percentage. The comparative income statement contains the same columns as the comparative balance sheet and provides the same type of information. As the income statement presents the review of the operating activities of the business and the comparative balance sheet shows the effect of operation of its assets and liabilities. The latter contains a connecting link between the balance sheet and income statement. Income statement and balance sheet are contemporary documents and they highlight certain important facts.

2. Trend Analysis

The trend statement analysis of various item of financial statement, figures of a single year are not enough. Comparative figures of some more years are significant. Such comparative figures may be wither absolute figures of may be presented in percentage form. If the item of one year, which may be called base year, are compared with similar item of other year in the form of percentages, the methods is known as trend percentages method or trend ratio method. The Common sized Statement so far discussed do not provided any common base with which all item in each stamen can be compared. For this
purpose common size statement are presented in which all item are compared with one common item. It is also analysis of balance sheet and Profit and Loss Accounts. In Balance sheet, total assets and liabilities is taken as 100 and all item are presented as percentage of total assets and liabilities. And In Profit and Loss Account, sales is base taken as 100 and all individual item of expense and incomes are shown as percentage of sales.

The different approaches of trend analysis are (I) Common Size Vertical Analysis and (II) Common Size Horizontal Analysis. Trend analysis helps the analyst and management to evaluate the performance, efficiency and financial condition of an enterprise as follows:

(A) **Common Size Vertical Analysis:**

All the statement may be subject to common size vertical analysis a figure from the same year’s statement is compared with the basic figure selected from the statement should be converted in to percentage to some common base. The common size vertical income statement and balance sheets of Aluminum group of companies covered by this study are given in the study.

(B) **Common Size Horizontal Analysis:**

When asking horizontal analysis, a figure from the account is expressed in terms of same account figures from selected base year. It is calculation of percentage relation that each statement then bears to the same item in the base year. Horizontal analysis can help the analysis to determine how an enterprise has arrived at its current position.

The technique of common size statement is very useful when we wish to compare the performance of one company with that of another for presentation of the data in percentage form since it eliminates problems relating to differences in organization size.

3. **Statement of Changes in Working Capital**

As we have seen earlier the excess of current assets over current liabilities is known as working capital. The amount of working capital is of prime important of the
management, since most of transaction affects working capital. The practice has therefore developed to prepare statement shown changes in the working capital. There are various methods used to show such changes. One of the methods generally used to prepare a statement with four columns to show such changes. In the first column the values of current assets and liabilities of the current year are shown, while in the second column the current assets and liabilities of the previous year are written. The third and fourth columns are meant for indicating either increase or decrease in the working capital due to changes in assets and liabilities. The net effect of changes of all current assets and current liabilities is shown at the end of the statement, which would disclose where the working capital has increased or decreased.

4. Cash Flow Analysis

The fund flow statement indicates changes in working capital which have taken place during the year. But the management is more interested in the changes in cash inflow and outflow in the short run. It is historical statement which indicated the cash inflows during the last year and would guide the management in framing policy regarding cash management. The cash budget shows the projected in flow and outflow of cash for the future budget period, while the cash flow statement is prepared on the basis of historical financial statement.

5. Fund Flow Analysis

In a statement which shows the inflow and outflow of funds during the year, the meaning of the world fund is working capital. The objective of preparing such a statement is to show to the management and other interested parties, what funds have come to the business and how they have been applied. A Balance sheet is a static statement showing the condition of assets and liabilities on a particular date only. While the fund flow statement is a dynamic statement showing changes that have taken place during the year.
6. Value Added Statement

In manufacturing business, the company purchase raw material from outside and through manufacturing process, convert them into finished products and thus add to the value. It is the values of services rendered by various parties connected with business. This added values is distribution among various parties who have contributed to its. Workers and other employees are paid wages and other benefits of their services, the providers of capital get dividend and interest, the supplier of convenient social infrastructure. Thus, there is a system of evaluating business performance by means of value added also so some of the companies give value added statement in their annual report along with other financial Statement.

7. Ratio Analysis

A Ratio is figure showing the logical relationship between any two items taken financial Statement. A number of ratios are used by financial analysis. They can be classified as profitability ratio, activity ratio, liquidity ratio and solvency ratio. The use of ratio for the purpose of arriving at some conclusion regarding some aspects of performance or financial position of business is known as ratio analysis.

Ratios analysis is the process of determining and presenting in arithmetical terms the relationships figures and groups of figures drawn from these statements. A ratio expresses the results on the basis of comparison of two figures in numerical terms.

A ratio is a statistical yardstick that provides a measure of relationship between two accounting figures. According to Batty “Accounting ratios describe the significant relationship which exists between figures shows on a balance sheet in a profit and loss account in a budgetary control system or in any other part of accounting organization.”

The ratio is customarily expressed in following ways:

- It may be obtained by dividing one value by other. This expression is known as “Times”
- If hundred then the unit of multiply the above expression becomes percentage.
- It may be expressed in the form of “proportion” between the two figures or known as pure ratio. it may also be depicted in the form of graphs like ratio graph.
References:-

17. Operating Leverage may be defined as a change in EBIT for a given change in Sales.
