CHAPTER-2
CONCEPTUAL FRAMEWORK OF
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2.1 INTRODUCTION:

The term performance cannot be put into a tight framework of definition. It is indistinct phenomenon and it can be interpreted and measured in different ways. Different users from their own point of views can evaluate from various angles and performance. A financial analyst will judge the performance from profitability and growth point of view. An economic planner will be concerned with the equal distribution of gains and wealth besides efficient utilization of resources. A welfare economist will be concerned with the equal distribution of gains and wealth besides efficient utilization. From the national viewpoint the various indicators of performance can be employment generation, research and development, health education and economic development etc. Moreover different parties viewpoint performance differently. The shareholders are interested in profitability where as their management is interested in the growth of the company. So, both of dimension viz. profitability and growth should be considered while analyzing performance of a company. Some researchers have used profitability and growth as measurement of performance.

2.2 FINANCIAL PERFORMANCE:

2.2.1 PERFORMANCE:

Performance is defines different literature to different describe. Some literature definition as under:

According to Erich L. Kohlar, “It is a general term applied to a part or to all of the conduct 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.” Robert Albanese, “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.”

So performance is refers to presentation with quality and result achieved by the management of company.

2.2.2 FINANCIAL PERFORMANCE:

“Financial performance is scientific evaluation of profitability and financial strength of any business concern” according to Kennedy and Macmillan financial statement analysis attempt to unveil the meaning and significance of the items composed in profit and loss account and balance sheet. The assists are the management in the formation of sound operating and financial policies.

According to accounting point of view financial statement are prepared by a business enterprise at the end of every financial year. “Financial statements are end products of financial accounting.” They are capsulated periodical reports of financial and operating data accumulated by a firm in its books of accounts- the General Ledger.

➢ One of the most fundamental facts about businesses is that the operating performance of the firm shapes its financial structure.
➢ It is also true that the financial situation of the firm can also determine its operating performance.
➢ The financial statements are therefore important diagnostic tools for the informed manager.

2.3 FINANCIAL EFFICIENCY:

Financial Efficiency is a measure of the organization’s ability to translate its financial resources into mission related activities. Financial Efficiency is desirable in all organizations regardless of individual mission or structure. It measures the intensity with which a business uses its assets to generate gross revenues and the effectiveness of producing, purchasing, pricing, financing and marketing decisions. At the micro level, Financial Efficiency refers to the efficiency with which resources are correctly allocated among competing uses at a point of time. Financial Efficiency is a measure of how well
an organization has managed certain tradeoffs in the use of its financial resources. Financial Efficiency is regarded efficiency and is a management guide to greater efficiency the extent of profitability, productivity, liquidity and capital strength can be taken as a final proof of financial efficiency.

It is interesting to note that sometimes, even sufficient profits can mask inefficiency and conversely, a good degree financial efficiency could be dressed with the absence & profit.

2.4 EFFICIENCY AND PERFORMANCE:

The word efficiency as defined by the Oxford dictionary states 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.

Fatless and speedy compliance to the process or system procedure is a measure of efficiency. Providing a specified volume and quality of service with the lowest level of resources capable of meeting that specification, performance measures and or indicators are required. These include measures of productivity, unit o volume of service etc. These measures help in minimizing of the resources in achieving the organizational objectives.

Performance is the execution or accomplishment of work feats etc. or a particular, action, deed or proceeding is refers as performance. However, the manner in which or the efficiency with which something reacts or fulfils its intended purpose is defined as performance. Performance may thus, mean different things to different businesses. Success or failure in the economic sense is judged in relation to expectations, return on invested capital and the objective of the business concern.

In understanding the term performance, a clear distinction needs to be drawn between Performance Measures and Performance Indicators. Performance measures need to be based on cat evaluation of the causes and effects of policy intervention whereas a performance indicator is less precise and usually provides only intermediate measure of achievement.
2.5 **MEASUREMENT OF PERFORMANCE:**

According to Tripathi, “Measurement is 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 objects itself but also its characteristic of being present. We never measure people only by their age, height, weight or some other characteristics.”

While measuring the performance of the company the first requirements is the thought and goals of human being are mostly realized thought the establishments of diverse kinds or relevant association.

2.6 **FINANCIAL PERFORMANCE ANALYSIS:**

In short, the firm itself as well as various interested groups such as managers, shareholders, creditors, tax authorities, and others seeks answers to the following important questions: (1) **What is the financial position of the firm at a given point of time?** (2) **How is the Financial Performance of the firm over a given period of time?**

These questions can be answered with the help of financial analysis of a firm. Financial analysis involves the use of financial statements. A financial statement is an organized collection of data according to logical and Conceptual Framework consistent accounting procedures. Its purpose is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment of time as in the case of a Balance Sheet, or may reveal a series of activities over a given period of time, as in the case of an Income Statement. Thus, the term ‘financial statements’ generally refers to two basic statements:

The **Balance Sheet** shows the financial position of the firm at a given point of time. It provides a snapshot and may be regarded as a static picture. “Balance sheet is a summary of a firm’s financial position on a given date that shows Total assets = Total liabilities + Owner’s equity.”

The **income statement** referred to in India as the profit and loss statement reflects the performance of the firm over a period of time. “Income statement is a summary of a
firm’s revenues and expenses over a specified period, ending with net income or loss for the period.”

However, financial statements do not reveal all the information related to the financial operations of a firm, but they furnish some extremely useful information, which highlights two important factors profitability and financial soundness. So, analysis of financial statements is an important aid to financial performance analysis. Financial performance analysis includes analysis and interpretation of financial statements in such a way that it undertakes full diagnosis of the profitability and financial soundness of the business. “The analysis of financial statements is a process of evaluating the relationship between component parts of financial statements to obtain a better understanding of the firm’s position and performance.” The financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account.

The first task is to select the information relevant to the decision under consideration from the total information contained in the financial statements.

The second is to arrange the information in a way to highlight significant relationships. The final is interpretation and drawing of inferences and conclusions. In short, “financial performance analysis is the process of selection, relation, and evaluation.”

2.7 AREAS OF FINANCIAL PERFORMANCE ANALYSIS:

Financial analysts often assess firm's production and productivity performance, profitability performance, liquidity performance, working capital performance, fixed assets performance, fund flow performance and social performance. However in the present study financial health of GSRTC is measured from the following perspectives:

1. Working capital Analysis
2. Financial structure Analysis
3. Activity Analysis
4. Profitability Analysis.
2.8 OPERATIONAL EFFICIENCY:

Operational Efficiency of an organization is the ability utilizes its available resources to the maximum extent Operational Efficiency can be judged in the light of financial efficiency. It can be said that neither profitability ratios nor turnover ratios by themselves provide good indicators measure operational efficiency.

Operational Efficiency of a bank is associated with diverse aspects such as operational cost effectiveness profitability, customer services, priority sector lending, and deployment of credit in rural and backward regions and mobilization of deposits.

In short, it is said that it is the ability to utilize the available resources in order to carry out operational activities of the automobile industry, which reveal its success failure in providing automobile products to its customers.

2.9 CONCEPT OF APPRAISAL:

Appraisal is closely related to scrutiny of the working systems of company as whole. According to Sudha Nigam, “Appraisal is techniques to evaluate past current and projected performance of concern.”

It is powerful applied tool to examine, to measure, to interpret and to weight critically and draw outputs. An appraisal is done by different specialist who examines the specific problems with their company. Appraisal can be divided into two parts

(I) Internal (II) External.

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

2.10 CONCEPT OF FINANCIAL PERFORMANCE APPRAISAL:

Simply, financial appraisal is a scientific evaluation of the profitability and financial strength of any business concern. In fact, financial analysis is the process of making an anatomical study of the financial and operational data contained in the profit and loss account and the balance sheet of a given concern and thereby satisfying the information needs of the internal and external users of such data. On the other hand,
financial appraisal is the process of scientifically making a proper and comparative evaluation of the profitability and financial health of the given concern on the basis of summarized and analyzed data, i.e., the output of financial analysis.

Thus, it follows from the above that the analysis of financial statements is a preliminary step towards the financial evaluation of the results drawn by the analysts or management accountants. Obviously, the appraisal of such results is made of the management for decision-making process.

Thus, it is evident that the financial appraisal begins where the financial analysis ends, and financial analysis starts where the summarization of financial data in the form of profit and loss account and balance sheet ends. In other words, financial appraisal is the end of that continuous flow of accounting cycle, which starts from classification, recording, summarizing, presentation and analysis of data and ends with the interpretations of the results obtained from such an analysis. Notably, in practice the accounts division of a business enterprise performs the entire exercise, up to the point of analysis of the financial and accounting data whereas appraisal or evaluation part is the major concern of management because ultimately, decision-making and policy-formulation are the prerogative of management. The analysis and interpretation of financial statements is an attempt to determine the meaning and significance of the financial statement data, so that forecast may be made of the prospects for future earnings, ability to pay interest and debt maturities both current and long-term and profitability of a sound dividend policy.

Financial statements of a business enterprise are valuable in the sense that they depict how the financial data of the related enterprise fit into the fabric of its accounting system. The analysis and interpretation of the financial statements result in the presentation of information that will aid in decision-making by business managers, investors and creditors as well as other groups who are interested in the financial status and operating results of a business. According to Moore, financial analysis is a process of syntheses and summarization of financial and operative data embodied in the financial statements, with a view of getting an insight into the operative activities of a business enterprise. Weasel views it as a technique of X-raying the financial position as well as the
progress of the company. By establishing strategic relationships between the components of balance sheet and profit and loss account and other operative data, financial analysis eventually unveils the meaning and significance of the various items embodied in the financial statements, also known as the financial Blue Prints of a business concern.

As mentioned earlier, the major and the most significant financial statements of a business concern are the profit and loss account and the balance sheet. While the profit and loss account is a dynamic statement that records income and expense between the two balance sheets dates, the balance sheet is a static statement, which shows the financial position on a certain date. Thus, the latter is an instantaneous photograph of the assets, liabilities and net worth of an enterprise at a particular unit of time. The analysis of both these statements gives a comprehensive understanding of business operations of a related concern as also of their impact on the financial health. A careful examination of profit and loss account throws ample light on the operating efficiency, inventory management, and control over indirect overheads and dividends policies pursued by the concern. Moreover, a study of the major individual items of a statement in relation to some other items of other statement will measure the activity and the profitability of the enterprise. Since both the major financial statements are interrelated, the exclusive analysis of either of them would not lead to any purposive exercise.

The main purpose of financial analysis is to make available to creditors, stockholders and the general public adequate information about and evaluation of a corporation's financial conditions of special interest to banks and other traders of funds to corporations are the various ratios that enable creditors and investors to appraise the progress of a company. These ratios help in comparing current accomplishments and financial prospects of a business corporation with those of its past as well as with those of similar corporations. The public and particularly the investors in corporate securities are concerned about the soundness of a business in which they have purchased, or contemplate purchasing, a share of ownership. The analysis of a corporation's securities requires evaluation of its past performance as reflected in the previous financial statements and of its probable future progress considering the overall business environment and futuristic trends.
2.11 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.

2.12 CONCEPT AND MEASUREMENT OF PROFITABILITY:

Profit is the main goals for establishing business concern. Profit is the primary motivating force for economic activity. Profit has to be earned and they have got to be earned on a regular basis. Business concerns that are unable to generate efficient profit from their operation cannot remunerate the providers of their capital and this makes it difficult for them to maintain the continuity of their existence. Profits are needed not only to remunerate capital but also to finance growth and expansion.

Insure the survival of a firm in a growing economy. If the firm is to survive in competitive and expanding environment, it has to go on expanding the scale of its operations on a regular and continuing basis. “Profits are the record card of the past, the inventive lode star for the future. If an enterprise fails to make profit, capital invested is eroded and in this situation prolongs the enterprise ultimately ceases to exist.”

Thus profit is the soul of the business concern without which it becomes weak and lifeless. Profit can rise when the price paid by the customers for the product of the business firm exceeds the cost that has been incurred from it. Accountants, economists, and others have defined profit in a number of ways as per its use and purpose. There have been many theoretical discussion of the concept of profit, but there is no consensus on the precise definition of this theoretical construct. There are main two concepts one is accounting concept and other is economics concept.

2.12.1 ACCOUNTING PROFIT:

“The excess of revenue over related costs applicable to a transaction, a group of transaction of an operating profit is profit” In accounting profit is generally known as the excess of total revenue over total costs associated with these revenues for the period. As
such the residue of income after meeting all the “explicit”, items of expenditure is termed as profit” Explicit items of expenditure generally, includes, raw material consumed, direct expenses, salaries, & wages, administrative expenses, selling and distribution expenses, depreciation and interest on capital of business firm. “The different between the sales and the costs of producing and selling that product is its profit.”

2.12.2 ECONOMIC PROFIT:

Back in 1939 the famous economist J.R.Hicks defined a man’s income as “the maximum value, which he can consume during a weak, and still expect to be as well of at end of the weak as he was at the beginning” Economics profit is the residual of income meeting all the ‘expil’ and ‘implicit’ items of expenditure for a given period. The term explit item of expenditure has the same meaning that have discussed in “accounting profit” but the implicit item of expenditure includes the amount of those factors of production, which are owned by owner.

For examples the rent of own land and building, the interest of own capital and salary of owner are termed as “implicit costs” or “opportunity costs”. However, the term economic profit in the form of equation can be represented as under:

Economic profit = accounting profit - implicit costs

OR

Economic profit=total revenue- (Explicit costs + implicit costs)

In economic the accounting profit known as gross profit while the profit remaining after subtracting the implicit cost of owner’s times and capital invested is known as “pure profit”

2.12.3 BUSINESS PROFIT OR INCOME:

Businessmen and accountants usually look upon the entire return to stakeholders’ profit or income, and do not regard any part of return as a cost. Thus business profit plus the normal return on investment, which is also the different between end-of – period wealth and initial investment.

2.12.4 SOCIAL PROFIT:

The business units are using scares resources of the society. So they should be accountable towards the society, which provided the resources. Therefore social
responsibility of the enterprise has been stressed. An increasing awareness of the social responsibilities on the part of business units has led to the discussion of “social profit”, Eichror and clerk about associates of US has suggested “social statement approach for social accounting in which the term ‘social profit’ or surplus has been defined. Unearths approach the excess of social benefits over social cost is termed as “social profit” or social surplus. The social benefits made available to the society by the business unit include the employment generation, payment for goods and other services, taxes paid contributions, dividends and interest paid, additional direct employee benefits like creating good township, offering good condition of work environmental improvements. Any cost, sacrifice that proves a detriment to society, whether economic or non–economic, internal or external is termed as social costs. Social costs include goods and materials acquired, buildings and equipment purchased, labor and services used, noise pollution solid waste visual and aesthetic pollution.

2.12.5 ACCOUNTING PROFIT AND ECONOMIC PROFIT:

The concept of accounting profit and economic profit differ from each other from the view point of opportunity cost of capital invested and cost of owner’s time .for calculation of economic profit, opportunity cost capital and owner’s time is considered while calculating accounting profit it is ignored by accountants. In accounting “the profit is deemed to be the joint result of various factors of production while in economics, it is termed as the rent liability, wages of owner and the reward of risk bearing.

2.12.6 VALUE ADDED CONCEPT:

The concept of value added is a concept broader than the concept of accounting profit and economic profit; it is a basic and broad measure of judging the performance of an enterprise. It is infect a measure of the utility that a business enterprise adds to the bought in materials and services. No business enterprise can survive or grow, if it fails to generate wealth. The business firm may exist without making profit but cannot survive without adding value. Thus shows the greater importance of value added devices which led a large number of western countries and many Indian companies to present value Added Statements (VAS) in their annual reports.
Value added is an excess of turnover plus income from service over the cost of bought in material and services. The term ‘turnover’ means the total amount of sales of goods plus duties and sales taxes less the amount of sales returns Goods plus used for self consumption, commission, rebates and discount allowed etc.

The term ‘income from services’ include the rewards for services to subsidiary companies in the form of dividends from it rent received compensation and miscellaneous income etc. The term “bought – in –materials includes costs of finished goods purchase, the cost of raw material consumed and the cost of stores and spare consumed during manufacturing process. This figure is further adjusted stocks of work in progress” and finished goods. The term cost of services includes the cost of production services, power, fuel, repair & maintenance, bank charges, commission, insurance premium, selling and distribution expenses, postages & telephone bills, printings, auditing fees. Legal expenses and traveling expenses, it should be kept in mind that the employees, cost depreciation and excise duty are not included in the cost of bought-in-material & services. They are separately shown

2.12.7 CONCEPT OF PROFITABILITY:

The word “Profitability” is modulation of two words “profit’ and “ability”. In another words it referred to “Earning power” of “operating efficiency” of the concerned investment concept of profitability may be defined as “The ability of a given investment to earn a return from its use”

Measurement of profitability is the overall measure of performance profits known, as bottom lines are also important for financial institutions. Analyzing and interpreting various types of profitability ratios can obtain creditor performance of portability.

2.12.8 PROFITABILITY AND EFFICIENCY:

‘Profitability is also not synonymous with ‘efficiency’ though it is an index of efficiency; it is regarded as a measure of efficiency and management guide to greater efficiency. No doubt, profitability s an important yardstick of efficiency, but the extent of profitability cannot be taken as a final proof of efficiency. Some time satisfactory profits can mask inefficiency and conversely, a proper degree of efficiency can be accompanied
by an absence of profit. The net profit figure simply reveals a satisfactory balance between the values receive and value given. The change in operational efficiency is merely one of many factors on which profitability of an enterprise largely depends besides efficiency, which affects the profitability.

2.13 CONCEPT OF LIQUIDITY:

The concept of liquidity within a business is important to understand the financial management, as it is the basic criteria to test the sort term liquidity position of the enterprise. Liquidity may be defined as the ability to realize value in money the real liquid asset. It has two dimensions [A] The time required to convert the assets money and [B] The certainty of the realizable price.

Generally the term ‘liquidity’ means conversion of assets in to ‘cash’ during the normal course of business and to have regular uninterrupted flow of cash to meet outside current Liability as and when due and payable and also the ensure money for day to day business operations. Hence the flow of current assets should circulate with such a rapid speed that they are converted into cash within a year so that timely payment may be made to outsiders for interest, dividends, etc.

If a major part of current assets is blocked in inventories and credit cells, not only ready cash will not be available to pay current debt but there is a risk shrinkage in the total current assets available because of possible fall in the value of inventories or possible losses an account of bad debts. The quality of current assets is therefore very important for analyzing liquidity.

◊ SIGNIFICANCE OF THE LIQUIDITY ANALYSIS:

The importance of adequate liquidity in the sense of the ability of a firm to meet current/short-term obligations when they become due for payment cash hardly is over-stressed. In fact liquidity is a pre-requisite for the very survival of a firm.

The short-term creditors of the firm are interested in the sort-term solvency or liquidity of a firm. But liquidity implies, from the viewpoint of utilization of funds of the firm that funds are idle or they earn very little. A proper balance between the two contemporary requirements i.e. liquidity and profitability is required for efficient
financial management. The liquidity ratio measures the ability of a firm to meet its short-
term obligation and reflects the short-term financial strength/solvency of a firm.

2.14 CONCEPT OF ACTIVITY ANALYSIS:

Sale of product is the primary object of any business enterprise. It is pivot around
which all business operations are cluster. The increase or decrease of the business profits
depends upon the magnitude of sale because it is the key figure in the business enterprise.
Income from net sales is the lifeblood of business. More sales more profit and less sales
less profit or even there may be loss. Thus-sale are to a business enterprise what oxygen
is to the human being, a very material increase in the volume of net sales has the same
effect upon the business organization as an increase in the quantity of inhaled oxygen has
upon the human organism. The quantity quality and regularity of flow of sales revenue
govern the physical appearance and the internal conditions of the business organism. In
fact with the higher volume of sales, the business operates with greater profits and
effectiveness and operations are speeded.

It is apparent, therefore that the significance of any business activity can be
measured in terms of its contribution towards sales. Activity ratios are turnover ratios
where the significance of financial figure is measured in terms of sales of business
enterprise. The approach to the activity analysis is done as follows:

1. The growth of activity and its measurement in terms of investment.
2. Activity in relations to total resources
3. The conduct of activity

2.14.1 GROWTH OF ACTIVITY:

The growth in the firm has been measured in terms of the growth of average
year’s sales over the period of study.

2.14.2 ACTIVITY IN RELATIONS TO TOTAL RESOURCES:

Activity ratios are concerned with how efficiency the assets of the firm are
managed or utilized. These ratios indicate the rate at which different assets are turned
over in the process of doing business. The greater rate of turnover or conversion, the
more efficient the utilization or management, other things being equal, resulting in higher
profitability. Sometimes these ratios are called efficiency ratios, or investment turnover ratios. Thus, Turnover ratios reflect the relationship between the level of the sales and the various assets and a proper balance between assets and sales shows better management of assets. Different activity ratio have been computed for judging the effectiveness of assets utilization

2.14.3 CONDUCT OF ACTIVITY:

The conduct of activity of an enterprise is related to the efficiency of conducting business operations. The efficiency of the conduct of activity depends upon the capacity to keep the operating cost at minimum possible level. An efficient conduct of business operations requires that expenses should always be kept at the minimum so that they may also remain below revenue resulting in profit thereby.

The operating ratio is an index of the efficiency of the conduct of business operations and analysis of operating ratio to judge the operating efficiency of an enterprise, requires a study of the main component ratio.

2.15 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.

2.16 **FINANCIAL STATEMENT ANALYSIS:**

2.16.1 **FINANCIAL STATEMENT:**

Every business concern wants to know the various financial aspects for effective decision making. The preparation of financial statement is required in order to achieve the objectives of the firm as a whole. The term financial statement refers to an organized collection of data on the basis of accounting principles and conventions to disclose its financial information. Financial statements are broadly grouped into two statements:

I. Income Statements (Trading, Profit and Loss Account)

II. Balance Sheets

In addition to above financial statements supported by the following statements are prepared to meet the needs of the business concern:

- Statement of Retained Earnings
- Statement of Changes in Financial Position

The meaning and importance of the financial statements are as follows:

(1) Income Statements: The term 'Income Statements' is also known as Trading, Profit and Loss Account. This is the first stage of preparation of final accounts in accounting cycle. The purpose of preparing Trading, Profit and Loss Accounts to ascertain the Net Profit or Net Loss of a business concern during the accounting period.

(2) Balance Sheet: Balance Sheet may be defined as "a statement of financial position of any economic unit disclosing as at a given moment of time its assets, at cost, depreciated cost, or other indicated value, its liabilities and its ownership equities." In other words, it is a statement which indicates the financial position or soundness of a business concern at a specific period of time. Balance Sheet may also be described as a
statement of source and application of funds because it represents the source where the funds for the business were obtained and how the funds were utilized in the business.

(3) Statement of Retained Earnings: This statement is considered to be as the connecting link between the Profit and Loss Account and Balance Sheet. The accumulated excess of earning over losses and dividend is treated as Retained Earnings. The balance of retained earnings shown on the Profit and Loss Accounts and it is transferred to liability side of the balance sheet.

(4) Statement of Changes in Financial Position: Income Statements and Balance sheet do not disclose the operational efficiency of the concern. In order to measure the operational efficiency of the concern it is essential to identify the movement of working capital or cash inflow or cash outflow of the business concern during the particular period. To highlight the changes of financial position of a particular firm, the statement is prepared may emphasize of the following aspects:

- Fund Flow Statement is prepared to know the changes in the firm's working capital.
- Cash Flow Statement is prepared to understand the changes in the firm's cash position.
- Statement of Changes in Financial Position is used for the changes in the firm's total financial position.

Financial analysis refers to an assessment of the viability, stability and profitability of a business, sub-business or project. It is performed by professionals who prepare reports using ratios that make use of information taken from financial statements and other reports. These reports are usually presented to top management as one of their bases in making business decisions.

- Continue or discontinue its main operation or part of its business;
- Make or purchase certain materials in the manufacture of its product;
- Acquire or rent/lease certain machineries and equipment in the production of its goods;
- Issue stocks or negotiate for a bank loan to increase its working capital;
- Make decisions regarding investing or lending capital;
Other decisions that allow management to make an informed selection on various alternatives in the conduct of its business.

2.16.2 FINANCIAL STATEMENT ANALYSIS:

Financial statement analysis is defined as the process of identifying financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account.

There are various methods or techniques that are used in analyzing financial statements, such as comparative statements, schedule of changes in working capital, common size percentages, funds analysis, trend analysis, and ratios analysis.

Financial statements are prepared to meet external reporting obligations and also for decision making purposes. They play a dominant role in setting the framework of managerial decisions. But the information provided in the financial statements is not an end in itself as no meaningful conclusions can be drawn from these statements alone.

However, the information provided in the financial statements is of immense use in making decisions through analysis and interpretation of financial statements.

2.17 OBJECTIVE FINANCIAL STATEMENT ANALYSIS:

- Prepare and interpret financial statements in comparative and common-size form.
- Compute and interpret financial ratios that would be most useful to a common stock holder.
- Compute and interpret financial ratios that would be most useful to a short-term creditor.
- Compute and interpret financial ratios that would be most useful to long-term creditors.

2.18 USERS OF FINANCIAL STATEMENT ANALYSIS:

Different classes of people are interested in the financial statement analysis with a view to assessing the economic and financial position of any business or industry in terms of profitability, liquidity or solvency. Such person’s bodies include:
2.18.1 SHAREHOLDERS:

Divorce between ownership and management and broad-based ownership of capital due to dispersal of are holding have made shareholders take more interest in the financial statement with a view to ascertaining the profitability and financial strength of the company.

2.18.2 DEBENTURE HOLDERS:

The denture holders are interest in the short term as well as the long-term solvency position of the company. They have to get their interest payment periodically and at the end the return of the principal amount.

2.18.3 CREDITORS:

Potential supplies of goods and materials and other doing business with the company are interest in the liquidity position of the company.

2.18.4 FINANCIAL INSTITUTION AND COMMERCIAL BANKS:

These financial institution are interested in the solvency – short term as well as long term and profitability position of the company.

2.18.5 PROSPECTIVE INVESTORS:

These are interest in the future prospects and financial strength of the company.

2.18.6 EMPLOYEES AND TRADE UNION:

These are interest in the profitability position of the company.

2.18.7 TAX AUTHORITIES:

They are interested in the profit earned by the company.

2.18.8 IMPORTANT CUSTOMERS:

Who want to make long standing contract with the company are interests in its financial strength.

2.18.9 GOVERNMENT DEPARTMENT:

They are dealing with the industry in which the company engaged are interest in the financial information relating to the company.

2.18.10 ECONOMISTS AND INVESTMENT ANALYSTS:

They are interested the financial and other information of company.
2.18.11 MEMBER OF PARLIAMENT:

The Public Accountant committee and Estimate Committee are interest in the financial information of the government companies.

2.18.12 SEBI AND STOCK EXCHANGE:

They are interested in the prospects and performance of companies with a view to protecting the interest of investors.

2.18.13 MANAGERS:

They are interested in knowing though the financial statement the present positions and future prospects of the company. This is mainly to review the company progress and position and take decision for the future.

2.19 NATURE OF FINANCIAL STATEMENT:

According to the American institute of certified public accountants: “Financial statement reflects a combination of record facts accounting convention and personal judgment and the judgment and conversation applied affect them materially”. This statement makes clear that the accounting information as depicted by the financial statement are influenced by three factors viz., recorded facts, accounting convention and personal judgment.

2.19.1 RECORDED FACTS:

The details revealed by the financial statements are based on the figures recorded in the books of accounts.

- The purchase and sales as well as wages shown in the trading account, expenses and incomes shown in the profit and loss account, assets like cash on hand, cash at bank, investments, fixed assets, debtors etc. are all taken from books of accounts. They are the historical records of transactions that occurred in the past and are stated at prices at which transactions took place.

- In other words, they do not disclose any transaction which cannot be recorded in the books of accounts for example the managing director of a company may be very efficient, but there is not accounting record of deterioration in his health or his death and is therefore not disclosed by financial statement even though such
events affect the profitability and financial position of the company adversely. Of course, now the recent trend is to disclose some such events which, throughout recorded in the account, but significant from the viewpoint of company’s business, are disclosed by companies.

- The financial statement show only those figures are which they are recorded in the books of accounts. For examples, the fixed assets are recorded at cost when they were purchased and the financial statements continue to show them at cost less depreciation. Many times, the current replacement cost of such assets is considerably more than the book value, but they are shown at cost because it is the cost at which they are recorded.

2.19.2 ACCOUNTING PRINCIPLES AND CONVENTIONS:

Financial statements are prepared according to Accounting principles, concept and conventions. For example according to the principle of periodicity, the financial statement are prepared at the end of each financial year, which gives rise to the problem matching cost with revenue, the adjustments for income received in advance outstanding expenses etc. are based on this convention only. The fixed assets are shown at cost less depreciation in the balance sheet because there is a principle of cost. The stock is valued at cost or market price whichever less is; provision is made for bad debts etc. are the result of principle of conservatism.

2.19.3 PERSONAL JUDGMENTS:

Although the preparation of financial statement is governed by accounting principles and conventions, many items are shown at figures which are the results of personal judgments of the accountant or the managing director.

- The accountant exercises his judgment in the selection of the method to be used in depreciation of fixed assets. The accountant may select straight line method or reducing balance method or number of hours of operation method. Of course, the element of personal judgment is reduced to the extent that consistency in the use of the same method is to be applied from year to year. Secondly, in respect of the rate of depreciation on various assets also, much latitude is left to the accountant;
thought check is applied by rates of depreciation being prescribed by company law.

- While using the accounting convention of valuing the stock at cost or market price, the accountant uses his personal judgment in selecting the method of calculating cost. He may use FIFO or LIFO or average cost method for this purpose.
- The percentage of bad debts reserve depends on personal are used as the basis, but there is no doubt that the personal opinion of the accountant plays a major role.
- It is the accountant who decides whether certain expenditure is a capital or revenue expenditure. The time period during which a particular intangible or fictitious asset is to be written off is left of the personal judgment of the accountant.

### 2.20 ESSENTIAL FEATURES OF FINANCIAL STATEMENT:

- The Financial Statement should be relevant for the purpose for which they are prepared. Unnecessary and confusing disclosures should be avoided and all those that are relevant and material should be reported to the public.
- They should convey full and accurate information about the performance position progress and prospects of an enterprise, it is also important that those who prepare and present the financial statement should not allow their personal prejudices to distort the facts.
- They should be easily comparable with previous statement or with those of similar concerns or industry. Comparability increases the utility of financial statement.
- They should be prepared in a classified form so that better and meaningful analyses could be made.
- The financial statement should be prepared and presented at the right time. Undue delay in their preparation would reduce the significance and utility of these statements.
- The financial statement must have general acceptability and understanding. This personal judgment and procedural choices exercise by the accountant.
• The financial statement should not be affected by inconsistencies arising out of personal judgment and procedural choices exercised by the accountant.
• Financial statement should comply with the legal requirements if any, as regards from, contents and disclosures and methods. In India, companies are required to present their financial statements according to the companies Act, 1956.

2.21 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. – 2.1 CLASSIFICATION OF FINANCIAL PERFORMANCE ANALYSIS**

2.21.1 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.

2.21.2 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.

2.22 IMPORTANCE OF FINANCIAL STATEMENT ANALYSIS:

The important of financial statement lies in their utility to satisfy the varied interest of different categories of parties such as management, creditors public etc.,

2.22.1 MANAGEMENT:

Increase in size and complexities of factors affecting the business operation necessitate a scientific and analytical approach in the management of modern business enterprises. The management ream requires up to date, accurate and systematic financial information for the purpose. Financial statement helps the management to understand the position, progress and prospects of business vis-a vis the industry. By providing the
management with the causes of business result, they enable them to formulate appropriate policies and courses of action for the future. The management communicates only through these financial statement, their performance to various parties and justify their activities and thereby their existence. A comparative analysis of financial statement reveals the trend in the progress and position of enterprises and enables the management to make suitable changes in the policies to avert unfavorable situations.

2.22.2 SHAREHOLDERS:

Management is separated from ownership in the case of companies. Shareholders can not directly, take in the day to day activities of business. However, the result of these activities should be reported to shareholders at the annual general body meeting in the form of financial statement enable the shareholder to know about the efficiency and effectiveness of the management and also the prospective shareholder could ascertain the profit earning capacity present position and future prospects of the company and decide about making their investment in this company published financial statement are the main source of information for the prospective investors.

2.22.3 LENDERS/CREDITORS:

The financial statement serves as a useful guide for the present and future suppliers and probable lenders of a company. It is through a critical examination of the financial statement that these groups can come to know about the liquidity, profitability and long term solvency position of a company. This would help them to decide about their future course of action.

2.22.4 LABOUR:

Workers are entitled to bonus depending upon the size of profit as disclosed by audited profit and loss account. Thus, Profit and Loss account becomes greatly important to the workers. In wages negotiations also, the size of profit and profitability archived are greatly relevant.

2.22.5 IMPORTANCE TO THE PUBLIC:

Business is a social entity. Various groups of society through directly not connected with business, are interest in knowing the position, progress and prospects of a business enterprise. They are financial analysis, lawyers, trade associations, trade
unions, financial press, research scholars and teachers, etc. it is only through these published financial statement these people can analyze, judge and comment upon business enterprise.

2.22.6 NATIONAL ECONOMY:

The rise and growth of corporate sector, to a great extent, influences the economic progress of a country. Unscrupulous and fraudulent corporate management shatter the confidence of the general public in joint stock companies, which is essential for economic progress and retard the economic growth of the country. Financial statement come to the rescue of general public by providing information by which they can examine and assess the real worth of the company and avoid being cheated by unscrupulous person. The law Endeavour’s to raise the level of business morality by compelling the companies to prepare financial statement in a clear and systematic form and disclose material information. This has increased the confidence of the public in companies. Financial statements are also essential for the various regulatory bodies such as tax authorities, registrar of companies, etc. They can judge whether the regulations are being strictly followed and also whether the regulation are producing desired effects or not, by evaluating financial statement.

2.23 LIMITATIONS OF FINANCIAL STATEMENT ANALYSIS:

The following limitations of financial statement must be taken into consideration by the analysts:

2.23.1 LESS ACCURATE:

Exact precision of the financial statement figures is not possible, because they deal with matters that cannot be stated precisely. The data are prepared according to accounting conversions developed by the accounting profession through many years of experiences.

2.23.2 SOME SIGNIFICANT ITEM OMITTED:

The statements do not show the exact position of the business, because it done not take into account some of the factors which affects its performance and financial position.
In other words, it shows the position of financial accounting of the business only. It does not disclose such matter which are not recorded in accounting.

2.23.3 Assets Not Shown at True Values:

A balance sheet does not show the value of assets, as understood in the ordinary sense. It presents the cost of assets less depreciation according to the accounting convention. In other words, the balance sheet does not show the market value or present replacement value of assets or that it does not show what a business is worth. Particularly during inflationary trends, the worth of assets is grossly underestimated, as the prices of assets would have increased manifold due to rising prices. Besides, the depreciation provided on the basis of old value would be very low, resulting in inflated profit and inadequate provision for replacing the assets.

2.23.4 Profit Figure Relative:

The profit shown by profit and loss account is relative and not absolute. It means that the profit figures of two concerns may be different only because they may adopt different basis for compiling the income statement, though they may use the same accounting convention.

2.23.5 Effects of Personal Judgment:

Though financial statements are prepared on the basis of generally accepted accounting principles conventions, personal judgment plays a significant role.

2.23.6 Does Not Satisfy All Parties:

The financial statement which are published are generally prepared to satisfy the requirements of company law and are to a large extent present from the viewpoint of shareholders and management. Other parties are however, convened with the company for creditors, workers, customers etc. whose requirement, they fail to satisfy.

2.23.7 Fails to Show All Liabilities:

Taking shelter under the accounting conventions and provision of company law, the balance sheet does not disclose all the liabilities of business. The most of companies do not included liabilities account of gratuity payable to their employee and as a consequence, the balance sheet fails to show the true financial position of the company.
2.23.8 BALANCE SHEET DATE:

The financial statements are prepared on a certain date for which there is neither any legal provision nor any accounting convention. Hence, most of the concerns select the balance sheet date in such a way that it will show a rosy picture of financial position.

2.24 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:

2.24.1 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 item 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
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.

2.24.2 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 with 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.

**2.24.3 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.

2.24.4 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.

2.24.5 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.

2.24.6 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.

2.24.7 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:

1. It may be obtained by dividing one value by other. This expression is known as “Times”
2. If hundred then the unit of multiply the above expression becomes percentage.
3. 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.
Conceptual Framework Of Financial Performance

❖ Importance:

A ratio is known as symptom like blood pressure. The pulse rate of the temperature of an individual often ratio analysis is used as a device to diagnose the financial position of an enterprise. It shall point out if the financial condition is very strong, good, partly good, and poor. As such the ratio analysis is a powerful tool of financial analysis through it economic and financial position of a business unit can be fully x-rayed. Ratio analysis becomes meaningful to judge the financial condition and profitability. Performance of a firm only when there is comparison of present in fact analysis involves two types of comparison.

First a comparison of present ratio with past and expected future ratios for the same firm, the second method of comparison involves comparing the ratio of the firm with those of similar firms of with industry average at the same point of time.

Further “Ratio analysis” presents the figures in which the net result of the financial position and problems is concentrated. They provide a co-ordinate frame of reference for the financial manage. They tell the entire story of the ‘Financial adventures of the enterprise as heap of financial date are buried them. They simplify the comprehensive of financial statistics.

On the basis of above it may be concluded that ratios are very important for interpretation as they give valuable and very useful information about business.

❖ Limitations:

Every flower of rose has its own beauty in spite of numberless thorns in the same way ratio analysis has a variety of advantages, though it is not free from limitations, some of which are as below:

- The formula for calculating each ratio is not well standardized.
- No standard ratios are available for evaluating the significance of each ratio.
- Ratio ignores non-monetary factors like general economic climate, government and management policies, which vitally affect the financial health of the enterprise.
- If too many ratios are calculated, they are likely to confuse, Instead of
revealing meaningful conclusions.

- The ratios are generally calculated from the past financial statement and thus, are no indicators of future.
- Ratios are not exact measure of financial situation as the balance sheet and profit and loss account are based on accounting conventions, personal judgments and recorded facts.

As ratios are simple to calculate, there is a tendency to over employ them, which lead to accumulation of mass data. However significant the ratio may they cannot replace business efficiency and decision-making. They do not provide mechanical solution to business problems.

Classification of Ratio:

Some writers have described that there are as many 42-business ratios. First of all it is necessary to ascertain the ratios for a particular study. The financial ratios may be classified in the various ways. If the nature and objective of calculating each ratio is given then, the regular and convenient was classification from the point of view of management and investors.

A. Profitability Ratio:

These ratios X-ray the profit making ability of the enterprise. They may calculate either on the basis of operating profit or net profit. These ratios are of two types first related to sales and second profitability. The main efficiency ratios are as given blow:

1. Gross profit Ratio
2. Operating Ratio
3. Net profit Ratio
4. Earnings Per share
5. Return on gross capital employed
6. Return on net capital employed
7. Return on net worth
B. **Liquidity Ratio**:  
These ratios throw the light upon the liquidity position of a concern the main ratios are given below.
1. Current Ratio  
2. Quick Ratio  
3. Inventory to working capital Ratio  
4. Stock Turnover Ratio  
5. Debtor turnover Ratio  
6. Average debt collection period.  
7. Working capital turnover Ratio

C. **Financial Structure Ratio**:  
These ratio highlight the management policies regarding trading on equity.  
The more important ratios concerning capital structure are given below.
1. Total debt equity Ratio  
2. Financial Leverage Ratio  
3. Net fixed assets to Net-worth Ratio  
4. Proprietary Ratio  
5. Total Assets To Debt Ratio  
6. Interest coverage ratio

D. **Activity Ratio**:  
Activity ratio expressed how efficiency the firm is managing its resources.  
These ratios express relationship between the level of sales and the investment in various assets. The import and commonly used activity ratios are given below.
1. Capital turnover ratio  
2. Fixed assets turnover ratio  
3. Current assets turnover ratio  
4. Raw Materials to net Sales Ratio  
5. Wages and Salaries to net Sales Ratio
6. Power and Fuel (Energy) to net Sales Ratio
7. Selling & Distribution to Net Sales Ratio
8. Depreciation to Sales Ratio

2.24.8 OTHER TECHNIQUES OF ANALYSIS:

In addition to comparative statements, common-size statements, and ratio analysis, analysts have many specialized tools and techniques which they can apply to special purpose studies. Such studies could include factors such as insurance coverage, the seasonal nature of the business, segment data, foreign operations, concentration of sales within a small number of customers, unusual events affecting the company, and the effect of inventory method (LIFO, FIFO) and depreciation methods on financial statements. Additional procedures that are available for use in special situations include:

1. **Gross margin analysis:**

   Gross margin analysis provides special insights into the operating performance of a company. It helps in evaluating overall gross margin by product mix.

2. **Breakeven, cost-volume-profit, and contribution analysis:**

   This tool discloses relationships between revenue and patterns of cost behavior for fixed and variable expenses. Different managers within a company use breakeven analysis because it is important when beginning a new activity, such as starting a new line of business, expanding an existing business, or introducing a new product or service. This topic is reserved for courses such as Analyzing Cost Data for Management or Cost Management.

3. **Return-on-investment analysis:**

   Return-on-investment analysis provides a comprehensive measure of financial performance. Especially, the ROI breakdown, known as the Du Pont formula, analysis gives an insight into how a company improves its performance. Special analytical procedures are available to isolate the different types of fluctuations as they relate to historical data and forecasts. When there is an established relationship between series, it is possible to use these relationships to make estimates and forecasts.
Time-series analysis is used where data classified on the basis of interval of time represent vital information in the control and operation of a business. The changes that can be isolated in time-series analysis represent the following major types of economic change: secular trend, seasonal variations, cyclical fluctuations, and random or erratic fluctuations.

Regression analysis is another tool of financial statement analysis. Regression analysis seeks to determine the relationship between financial statement variables.

Correlation analysis measures the degree of relationship between two or more variables. Time series, regression, and correlation analyses are more sophisticated techniques and are beyond the scope of this course.

So, several other techniques like cash flow analysis and break-even analysis are also sometimes useful for analysis. The use of various statistical techniques is also used frequently for financial analysis, providing a more scientific analysis. The tools generally applied are moving average, index number, range, Standard deviation, correlation, regression and analysis of time series. Diagrammatic and graph orientations are often used in financial analysis. Graphs provide a simplified way of presenting the data and often give much more vivid understandable of trends and relationships. Pie graphs, bar diagrams and other simple graphs are often used for financial analysis.

2.25 SIGNIFICANCE OF STUDY FOR STAKEHOLDERS:

The above study is made for the point of all live participants who are interested in the routine of the business organization. Those are as under.

2.25.1 MANAGEMENT POINT OF VIEW:

The above study plays vital role in providing such information to the management, which needs for planning decision-making and control e.g. operational efficiency analysis provides gross profit, operating expenses analysis and profit margin. Asset management outlines asset turnover, working capital under inventory turnover, accounts receivable and payable profitability position shows return on assets, earnings before interest and taxes (EBIT), and return on assets. Gesternberg stated that "management can measure the effectiveness of its own policies and decisions, determine
the advisability of adopting new policies and procedures and documents to owners as result of their management efforts.

2.25.2 IMPORTANT TO INVESTOR:

According to Erich A. Helfert “Importance of performance lies for owners investors should know easily. The financial position of the company by return on net worth, return on common equity, Earnings per share, Cash flow per share, Dividend yield, dividend coverage, Price earnings ratio, market to book value, Pay out/retention”

The potential investors of the business organization in turn are interested in the current features.

2.25.3 CREDITOR’S POINT OF VIEW:

Creditors doing business with company simply study its performance by current ratio, acid test ratio, and debt to assets, equity and capitalization, interest coverage and principal coverage before lending the finance. The study of these describes real features of business organization to the creditors.

2.25.4 GOVERNMENT POINT OF VIEW:

Government has significance to study liquidity productivity and financial efficiency of an individual organization or industry as a whole. Various taxes, revenues, financial assistance, sanctioning, subsidy, to a business organization or industry as well as price fixing policies, frame outlines the key role of study for the Government lies in planning, decision making and control process.

2.25.5 EMPLOYEES AND TRADE UNIONS POINT OF VIEW:

Employees are resources of the company and are interested to know the financial position and profit of the company. Generally they analyze by the comparison between past and present performance, profit margin and cash flow of the company. Trade unions are interested to know the data of financial performance pertaining to their demands for increase in wages, salaries, facilities, and social welfare.

2.25.6 SOCIETY AND OTHERS:

Society and others are including in external environment of the company and every business organization has a greater responsibility towards society. In this context performance should be studied through various types of social elements such as
customers investors, media, credit institutions, labour bureaus, taxation authorities, economists are interested for the study of a business organization while society as whole also looks forward to know about the social contribution, i.e., environmental obligations, social welfare etc.

2.26 CONCLUSION:

Performance is refers to presentation with quality and result achieved by the management of company and Financial Efficiency is a measure of the organization’s ability to translate its financial resources into mission related activities. So, the financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account. Company also calculated different type of profit and last Measurement of profitability is the overall measure of performance profits known, as bottom lines are also important for financial institutions. Analyzing and interpreting various types of profitability ratios can obtain creditor performance of portability.

A timely, consistent, and responsible investor relations program that informs the financial analyst in an unbiased manner. An ability to articulate and communicate the business philosophy and principal strategies of management and the way in which management is organized to carry them out. Many analytical tools and techniques of financial statement analysis are available. In determining which ones to use, consider its relevance, controllability, consistency, comparability, and simplicity.
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