Chapter: 2 Performance Analysis:

‘A Conceptual Framework’

2.1. Introduction:

Performance can be evaluated from various angles and by different users from their own point of views. 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. From the national viewpoint the various indicator 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 whereas their management is interested in the growth of the company. Therefore, both of these dimensions viz., profitability and growth should be considered while analyzing performance of a company.

In literature various researchers have used profitability and growth as measurement of performance. Profitability has been used as measure of performance. One of the financial indicators that give the utmost satisfaction to the investors is return that is generated by their investment but at the same time they are worried about the risk that is associated with their investment. Hence, it turns out to be very significant and vital for the financial managers to analysis and identified the risk and return associated with the investment.
2.2. 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.

Performance is the execution or accomplishment of work feats etc. or a particular, action, deep 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 objective of business concern.

Performance means an act, an execution. To perform is used for showing the fulfillment of a function or a role. Performance is also used for evaluation. To measure the action or to interpret the execution or action the performance word can be used.

According to Erich L. Kohlar¹ “It is a general term applied to a part or to all 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.”

According to Robert Albanese² “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.”
The above definitions describe that the word ‘Performance refers to presentation with quality and result achieved by the management of company. It considers the accomplishment of objectives as well as goals setting for the company comparing the present progress with the past, although in context of the present. It also covers financial cost and social aspects. Overall activities conclusion is represented by the term ‘performance’

2.3. Measurement of Performance:

“Measurement is process of mapping aspects of a domain into other aspects of a range according to some rule of correspondence”³

According to P.C.Tripathi⁴, “Measurement is the assignment of numerals to characteristics of objects, person, 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 objects itself but also its characteristics of being present. We never measure people only by their age, height, weight or some other characteristics”

According to Michael⁵ “Performance is dependents 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\textsuperscript{6} “The primary focus of financial reporting is information about an enterprise’s performance provided by measures of earnings and its components.”

Erich A. Helfert\textsuperscript{7} 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.”

The main object of preparing financial statements 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 statements 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 funds statements. According to Stanley B.\textsuperscript{8} “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 economic 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.

2.4. Financial Performance: Meaning:

Financial performance means the action taken by an organization in terms of money of capital of fund. The incomings and outgoings of money could be shown in the form of different statements i.e. profit and loss account, balance sheet and fund flow statement etc., Analysis means methodical classification of the data given in the financial statement. Analysis of financial performance from all point of view everybody interested in the particular corporate units, wants to know certain point like profit adequacy, rate of dividend, returned earning.

“Financial Performance is the snapshot of a position of concern and ability to withstand the ever changing environment. It is the blue print of the financial affairs of the concern and reveals how a business has prospered under the leadership of management personal. In fact, it can be said that financial performance is the medium of evaluation of management performance”.

“Financial Performance is a 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. To assists the management in the formation of sound operating and financial policies.
Financial performance refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the result of a firm’s policies and operations in monetary terms. It is used to measure firm’s overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation.

According to Accounting Point of view financial statements 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. For proper interpretation of financial statement, users must have a basic understanding of the conceptual framework and principles underlying their preparation. Otherwise users will not recognize the limits of financial statements.

The financial statement analysis facilitates a sufficient guideline about the behavior of financial variables for measuring the performance of different units in the Industry it also facilitates to indicate the current scenario of improvement in the organization.

2.5. 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 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 and the Income Statement.

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. Thus 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.”

2.6. Areas of Financial Performance Analysis:

There are such areas where the performance should be modified or improved by effective assessment of various types of activities performed by the business organization in different areas of operations. Those areas of operations may be termed as the areas of performance.

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 GSFC in measured from the following perspectives:

2.6.1. Performance of Profitability

2.6.2. Performance of Productivity
2.6.1. Performance of Profitability:

The word “Profitability” is modulation of two words ‘profit’ and ‘Ability’. In other words, it refers to ‘Earning Power’ or ‘Operating performance’ of the concerned investment. The concept of profitability may be defined as “The ability of a given investment to earn a return from its use”\(^{11}\).

Measurement of profitability is the overall measure of performance. Profits known as bottom line are important for financial institutions. Analyzing and interpreting various types of profitability ratios can obtain creditors performance of profitability.

2.6.2. Performance of Productivity:

Productivity is usually defined as a ratio of output produced per unit of resource consumed by the process. “Productivity is a measure of performance in producing and distributing goods and services: value added or sales minus purchases divided by workers employed”\(^{12}\)

2.6.3. Performance of Liquidity:

By checking the fluctuations most probably in current assets, the researcher can take the estimate of liquidity performance.
2.6.4. Performance of Working Capital:

Generally working capital is said to be the excess of current assets over current liabilities. It is used for regular business. As soon as the hearts get 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 kind may depict required information for the purpose.

2.6.5. Performance of Fixed Assets:

According to Foulke, Roy A. 13, “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, impact of gross block on sales and operating profit margin and operations consisting of loans and advances, Payment of wages, direct and indirect expenses, investments, and credit granted to customers and cash on hand. It is lifeblood of each bank. 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 is very important as it shows that owners have provided enough funds to finance fixed assets.

2.6.6. Performance of Fund-flow:

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

2.6.7. 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 the society.

2.7. Types of Financial Performance Analysis:

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

2.7.1. Material Used

2.7.1.1. External Analysis

2.7.1.2. Internal Analysis
2.7.2. Modus Operandi

2.7.2.1. Horizontal Analysis

2.7.2.2. Vertical Analysis

2.7.1. Material used:

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

2.7.1.1. 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.

2.7.1.2. 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.

2.7.2. Modus operandi:

On the basis of modus operandi financial performance can be analyze in the following two ways:
2.7.2.1. 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.

2.7.2.2. 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 on proper analysis of form’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.

2.8. The Need and Importance of Financial Performance Analysis:

The need and importance of financial performance analysis rise from the viewpoint of different parties, which are actively interested in the affairs of the banks. These parties are as below:-
2.8.1. Management:

According to Erich A. Helfert, “Managers are responsible for efficiency, current and long term profit from operations and effective development of capital and other resources in the process.” Performance appraisal may help the 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 performance appraisal.

2.8.2. Employees and Trade Unions:

Employees of the banks are interested in the profits and the financial position of a bank. The employees measure the efficiency of the bank with the satisfactory profit margin and adequate cash flow. The employees can compare the past performance and the present performance of bank by performance appraisal. Even trade unions of banks use performance appraisal of banks for demanding increase in wages and facilities.

2.8.3. Investors:

Investors are the real investors of any enterprise. In case of banking industry, the investors can know profitability, Productivity & Overall efficiency of the bank by studying performance appraisal of banks.

2.8.4. Depositors:

The depositors, wanted business with the bank, generally appraise the performance of a bank before depositing the money. The depositors are interested in the rate of interest offered by different banks, cash flow and liquidity of the banks,
facilities available against deposits. They can know these each aspect by referring performance appraisal of banks.

2.8.5. Government:

The government is keen interested in studying the performance appraisal of banking industry as a whole. By studying the performance appraisal of banks, the government can assess the growth of industries and economy. Moreover the government can take decision about tax structure and incentives for banking industry.

2.8.6. Society:

In the Society, there are various agencies like media, stock exchanges, economists, tax consultants and authorities, awakened citizens who are interested in the performance appraisal of banks. Their interest in the performance appraisal of banks becomes the interest of the society. The society at large also expects to know about the social performance such as environmental obligations, employment avenues and social welfare etc.

2.9. Techniques of Financial Performance Analysis:

An analysis of financial performance can be possible through the use of one or more tools / techniques of financial analysis:

2.9.1. Accounting Techniques:

It is also known as financial techniques. Various accounting techniques such as Comparative Financial Analysis, Common – size Financial Analysis, Trend Analysis, Fund Flow Analysis, Cash Flow Analysis, CVP Analysis, Ratio Analysis, Value Added Analysis etc. may be used for the purpose of financial performance. Some of the important techniques which are suitable for the financial performance of GSFC are discussed hereunder:
2.9.1.1. **Ratio Analysis:**

In order to evaluate financial condition and performance of a firm, the financial analyst needs certain tools to be applied on various financial aspects. One of the widely used and powerful tools is ratio or index. Ratios express the numerical relationship between two or more things. This relationship can be expressed as percentages (25% of Income), fraction (one – fourth of Income), or proportion of numbers (1:4). Accounting ratios are used to describe significant relationships, which exist between figures shown on a balance sheet, in a profit and loss account, in a budgetary control system or in any other part of the accounting organization. Ratio analysis plays an important role in determining the financial strengths and weaknesses of a company relative to that of other companies in the same industry. The analysis also reveals whether the company’s financial position has been improving or deteriorating over time. Ratios can be classified into four broad groups on the basis of items used: (1) Liquidity Ratio, (2) Capital Structure/Leverage Ratios, (3) Profitability Ratios, and (4) Activity Ratios.

2.9.1.2. **Trend Analysis:**

Trend analysis indicates changes in an item or a group of items over a period of time and helps to drown the conclusion regarding the changes in data. In this technique, a base year is chosen and the amount of item for that year is taken as one hundred for that year. On the basis of that the index numbers for other years are calculated. It shows the direction in which concern is going.
2.9.2. **Statistical Techniques:**

Every analysis does involve the use of various statistical techniques. Some of the important statistical techniques which are suitable for the financial performance of GSFC are discussed herein:

2.9.2.1. **Measures of Central Tendency:**

Measures of central tendency are also known as statistical averages. It is the single value which represents the whole series and is contain its measure characteristics. The main objective is to give a brief picture of a large group, which it represents, and to give a basis of comparison with other groups. Arithmetic mean, median, mode, geometric mean and harmonic mean are the main measures of tendency. Mean, also known as arithmetic average, is the most common measure of central tendency. It is defined as the value which obtained by dividing the total of the values of various given items in a series by the total number of items. It can be figured as:

\[ \text{Mean } (x) = \frac{X_1 + X_2 \ldots + X_n}{N} \]

2.9.2.2. **Index Number:**

According Lawrence J. Kaplan an index number is a statistical measure of fluctuations in a variable arranged in the form of a series and using a base for making comparison. The index number is used to represent diverse changes in a group of related variables. It represents changes in terms of rates, ratios or percentages called ‘relatives’ such as ‘price relatives’ (measures relative changes in prices), ‘quantity relatives’ (measures relatives changes in quantity) etc. Since it represents an average of relative changes in a group of related variables relevant to a given phenomenon they are often described as ‘barometers of economic change’.
2.9.2.3. **Diagrams & Graphs:**

Diagrams and graphs are visual aids, which give a bird’s eye view of a given set of numerical data. They present the data in simple readily comprehensible and intelligible form. Graphical presentation of statistical data gives a pictorial effect instead of just a mass of figures. They depict more information than the data shown in the table which through light on the existing trend and changes in the trend of the data.

2.9.3. **Mathematical Techniques:**

Financial analysis also involves the use of certain mathematical tools such as Programme Evaluation and Review Techniques (PERT), Critical Path Method (CPM), and Linear programming etc. However, they are not useful for the present study.

2.10. **Role of Financial Performance in Planning, Control and Decision-Making:**

Financial performance plays an important role in providing so many useful information to the bank 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 bank managements require various types of information, both qualitative, and quantitative. Financial performance has taken on increasingly the task of providing the quantitative 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 bank managements. This control is different from control over property and an asset, as it looks at things form such angles-
(A) That the work which had to be done has been done without loss of time and,

(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 on capital projects, such as expansion and diversification, financial performance provides and examines a great deal of information.

2.11. **Ratio Analysis as a Tool of Financial Performance:**

A Ratio is simply one number expressed as (1) Percentage (2) fraction and (3) a stated comparison between numbers According to Hingorani, Accounting ratios are relationships expressed in mathematical terms between figures with a cause and effective relationship or which are connected with each other in some manner or the other,” Ratio may be based on figures in the profit and loss account or in the balance sheet or in both. So the Ratio Analysis is the study of specific relationship and heart of the statements analysis.

Analysts use ratio to link different parts of the financial statements in an attempt to find clues about the status of particular aspects of the banks or any other business. The general procedure in ratio analysis involves the selection of two items from the financial statements and division of one item into the other to form a ratio. It points out either the financial condition of a bank or business is good or bad. It is universally used for appraising the performance of bank or business. The interpretation of ratios involves making comparison over time. Under this, the same ratio or for that matter a group of ratios is studied over a period of years with the result that significant trends indicating rise, decline or stability are highlighted.
Sometimes, the average value of a ratio for a number of years in the past can serve as a standard against which to judge current performance. The ratios of any given bank or business firm may be compared with the ratios of other banks or business firms existing in the same industry. Such an exercise can also be known as ‘Inter-firm comparison’ or “Inter-bank comparison”. Such comparisons are usually significant as in most cases; members of the same industry face the same or similar financial problems. Because of ratio analysis and comparison, much useful information can usually be brought under banks or business firms’ knowledge.

Further, the ratio analysis can be of invaluable aid to the bank or business firm in the discharge of its basic functions like planning, co-ordination, communication, control and forecasting. By an analytical study of the past performance and projecting the future, it assists in communication by conveying information which is pertinent and purposeful, to those for whom it is meant. It promotes co-ordination by a study of the efficiency of the bank or any other business. It paves the way for effective control of banking or business operations by undertaking an appraisal of both the physical and monetary targets. It is also true that, no one ratio will give the entire picture but they do tend to indicate, which cumulatively assists considerably in appraisal of the financial position and operations of the organizations.
References:


7. Erich A. Helfert, Techniques of Financial Analysis


