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CONCEPTUAL FRAMEWORK OF FINANCIAL PERFORMANCE

2.1 INTRODUCTION
The term performance cannot be put into a tight framework of definition. It is a vague phenomenon and it can be interpreted and measured in different ways. 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. A welfare economist will be concerned with the equal distribution of gains and wealth besides efficient utilization of resources. 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 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.

2.2 CONCEPT OF PERFORMANCE
The word ‘Performance is derived from the word ‘parfourmen’, which means ‘to do’, ‘to carry out’ or ‘to render’. It refers the act of performing; execution, accomplishment, fulfillment, etc. In broader sense, performance refers to the accomplishment of a given task measured against preset standards of accuracy, completeness, cost, and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished.

In the words of Frich Kohlar “The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with
reference to past or projected cost 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.”

Both the above definitions describe that the word ‘performance’ refers to presentation with quality and result achieved by the management of company. It carries into account the accomplishment of objectives as well as goals setting for the Company comparing the present Progress to the past. Although, in the context of the Present. Thus, not just the presentation, but the quality of results achieved refers to the performance. Performance is used to indicate firm’s success, conditions, and compliance. Study covers financial analysis aspects. Overall conclusion of the activities of the Companies is mentioned by one word i.e. ‘Performance’.

2.3 MEANING OF FINANCIAL 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.

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.
2.4 AREAS OF PERFORMANCE

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

2.4.1 PROFITABILITY PERFORMANCE:

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

2.4.2 LIQUIDITY PERFORMANCE:

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

2.4.3 WORKING CAPITAL PERFORMANCE:

Generally working capital is said to be the excess of current assets over current liabilities. It is used for regular business operations consisting of loans and advances, Payment of wages, direct and indirect expenses, investments, credit granted to customers and cash on hand. It is lifeblood of each business. As soon as the heart gets blood, it circulates the same in the body. In the same manner working capital funds are obtained and circulated in business operations. As and when this circulation stops, the business organization 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 company and the efficiency as regards utilization of working capital. Analysis of working capital statements and various ratios of its kind may depict required information for the purpose.
2.4.4 FIXED ASSETS PERFORMANCE:

The amount invested in these assets is realized gradually from every unit of sales made during the serviceable life of the assets. Analysis of fixed assets structure, average annual growth of fixed assets, and impact of gross block on sales and operating profit margin and efficiency in the use of fixed assets may depict the performance of fixed assets. Since the depreciation is directly related to fixed assets, the study of depreciation and the depreciation provision policy in using fixed assets can also be useful. As fixed assets in nature are along term tangible assets therefore, they should basically be financed through long-term sources. In this respect, the ratio of fixed assets to net worth can be calculated to study financing of fixed assets. This ratio is very important as it shows that owners have provided enough funds to finance fixed assets.4

2.4.5 FUND-FLOW PERFORMANCE:

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

2.4.6 SOCIAL PERFORMANCE:

The social performance of any company can be evaluated by considering different parties like government, creditors, investors, customer and employees. All these parties are members of the society. Some important accounting ratios can be helpful to know the contribution made by the company to the society.

2.5 CONCEPT OF FINANCIAL ANALYSIS

Financial statements are only the means of providing general information regarding operational results and financial position of a business. These statements merely contain financial data about business events which do not reveal any significant conclusions such as efficiency of the management, strength and weakness of the firm, index of future progress etc. The analysis is done by properly establishing the relationship between the items of balance sheet and profit and loss account. The first task of financial analysis to determine the information contained in the financial
statement. The second step is to arrange information in a way to highlights significant relationship. The final step is interpretation and drawing of inferences and conclusions. Thus financial analysis is the process of selection, reviewing and evaluation of the accounting information.

Financial analysis is a multipurpose and multidimensional technique which involves a systematic and careful examination of information contained in financial statements for a certain period. The use of this technique is an art which requires pertinent knowledge experience and intuition for its development. That is why it has been said that the science of financial analysis is assuming an increasingly important role worth of a going concern. It helps in drawing out the implications which are contained in the statement themselves.

The analysis of such statements provides valuable information. Analysis of financial statement is the systematic numerical calculation of the relationship between one fact with the other to measure the profitability, operational efficiency and the growth potential of the business. Thus the analysis of financial statement is basically a study of the relationship among various financial facts and figures as given in the set of statement in the words of “Metcaff and Titard” “Analyzing financial statement is a process of evaluating the relationships between component parts of financial statements to obtain a better understanding of a firms position and performance.”

Financial analysis is the evaluation of a firm’s past present and anticipated future financial performance and financial condition. Robert. H. Wessel has defined analysis and interpretation of financial state meant as “a technique of x-raying the financial position as well as the progress of a company.” In short financial analysis is a systematic and specialized treatment of information obtain in financial statements in order to measures the liquidity, profitability, solvency, operational efficiency and growth potential of an enterprise. It is an important tool for the analyst to identify the financial and operational strength and weakness of the concern.
2.6 AIM OF FINANCIAL ANALYSIS

The main aims of financial analysis are listed as follows:

1. To judge the financial health of the undertaking for management, creditors and bankers.
2. To judge the earnings performance of the company and facility with which dividends can be paid from out of earned profits. Potential investors are primarily interested in this aspect.
3. In case of institutional investor the analysis is carried over a long period with view to identifying companies having growth potential and a sound financial base.
4. To judge the ability of the company to pay the principal and interest, arrangements for amortization of debt and the security available for the loans extended.
5. To judge the solvency of the undertaking. The trade creditors are mainly interested in assessing the liquidity position for which they look into the following.
   - Whether the current assets are sufficient to pay off the current liabilities.
   - The proportion of liquid assets to current assets.
   - The business prospects with reference to the future growth and earning.

2.7 SIGNIFICANCE OF FINANCIAL ANALYSIS

According to Baruch Lev “Financial statements is an information processing system designed to provide data for decision making models, such as the portfolio selection model, bank lending decision models and corporate financial management models.”

This statement clarifies the important of financial analysis. Use of financial statement analysis is to measure liquidity, profitability, solvency and overall performance of the enterprise. The users may be the management of the concern profits itself over owners, creditors, investors, government, bankers, employees, economists, researchers etc. but the nature and purpose of analysis will differ with each of these analyses N. L. Gole says that “The analysis of financial statement spotlights on the significant facts and relationship concerning managerial performance, corporate
efficiency, financial strength, weakness and also credit worthiness that would have otherwise been buried in heap of detail.

The significance of financial analysis varies with varied users' of financial statement. Following parties interested in financial statement and their utility.

2.7.1. MANAGEMENT POINT OF VIEW

Financial statements are used by those persons who direct and control the business called management. These persons desire such information from these statement by which the efficiency and earning power of the firm can be measured and rational decisions for its efficient operation can be taken. These financial statements will serve to Management to analyze. The analysis and interpretation of financial data highlights the significant facts and relationships concerning various aspects of financial life of business entity. So every person who has interest in the business entity likes to take decisions based on analyzed and factor have also enhanced the significance of the analysis of financial statements.

1. Disclosure of Facts
2. Effective Decision Making
3. Effective Planning and Control
4. Measures Operational Efficiency
5. Comparative Study
6. Serving the Need of Interested Parties

2.7.2 INVESTORS POTENTIAL INVESTORS POINT OF VIEW

Shareholders and debenture holder fall in the category of investors. They need information to aid their decisions of buying selling or holding shares or debenture of reporting entity share holders have permanent interest in the company. Their main objective is the safety of capital and to receive adequate income thereon. Therefore, they need information regarding capital structure and future plans of the firm, to know the financial position, earning power, present value of shares and safety of their investments. Such information's are available to them through financial statements. Debenture holders want to be assured that debentures will be redeemed by the
company on due date. Thus, they are only interested in the long term solvency of the company, which they know from financial statements analysis. Financial statements analysis provides much important information to perspective investors.

2.7.3 CREDITORS POINT OF VIEW
Creditors are the persons who supply goods on credit. They are interested to know the financial soundness before granting credit and up to what extent.

2.7.4 RESEARCH SCHOLARS POINT OF VIEW
They can peep into financial policies perused by management and offer constructive suggestion to overcome the financial problem if diagnosed.

2.7.5 FINANCIAL INSTITUTIONS POINT OF VIEW
Before sanctioning credit, financial institution like to be assured about the liquidity solvency, financial strength and profitability of the borrowing concern which can be judged only through the analysis of financial statement.

2.7.6 GOVERNMENT AND THEIR AGENCIES POINT OF VIEW
Due to separation of management and ownership in enterprises; the government has enacted some laws for the protection of owners. Financial analysis helps the government to take proper decision. Financial Analysis also helps the government to determine tax liability, subsidy, price fixing, cost control and other regulation desirable in socioeconomic.

2.7.7 EMPLOYEES AND TRADE UNIONS POINT OF VIEW
Employees and their representative bodies are interested in the financial statement to ascertain the ability of the enterprise to maintain existing staff and serve them through appropriate remuneration and retirement benefit. Financial analysis helps them in knowing the profitability, liability and earning capacity of the concern provides assurance about their employment.
2.7.8 CUSTOMERS POINT OF VIEW

Customers have an interest in information about the continuance of an enterprise, especially whether they have a long term involvement with or without dependent on the enterprise.

2.7.9 SOCIETY AND OTHERS POINT OF VIEW

The society is also interested in the performance of an enterprise as it results in the increase of employment and standard of living. It is also concerned about the contribution of an enterprise towards social welfare.

2.8 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:

**Figure No: 2.1 Types of Financial Performance Analysis**

![Diagram of Types of Financial Performance Analysis]

2.8.1 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.

2.8.2 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.

2.9 TECHNIQUES OF FINANCIAL ANALYSIS
A number of such techniques are used by the financial analyst, but the most popular among them as follows
2.9.1 ACCOUNTING TECHNIQUES

Accounting techniques or tool which may use for financial analysis are many such as ratio analysis, common-size statement analysis, trend analysis, comparative statement analysis, Fund flow Analysis, cash flow Analysis, value added analysis etc. The users pick up the techniques to suit their requirements and also on the basis of data available to them.

2.9.1.1 Comparative Financial Statements

Comparison of financial statements for two or more years is another technique used in analyzing data. Comparative financial statements are statements of financial position of a business so designed as to provide time perspective to the consideration of various elements of financial position embodied in such statements. For this purpose the balance sheet and profit and loss account are prepared in comparative form. Comparative statements may be made to show.

- Absolute data (rupee amount or money value),
- Increase or decrease in absolute value data in terms of money value and
- Increase or decrease in absolute data in term of percentage.
2.9.1.2 Common-size Financial Statement

Profitability is an indication of the efficiency with which the operations of the enterprise are carried on. Quantification of profitability or measurement of profitability is needed for taking policy decision under difference circumstances. The profitability can be measured in terms of different components of income statement or balance sheet. The other tools of measurement cannot explain the changes that have taken place from year to year in relation to total assets, total liabilities or total net sales. Common size analysis can make a comparison between different size firms much more meaningful since the numbers are brought to a common base percentage. Common size statement converts financial statement by expressing absolute rupee amount into percentage.\(^9\)

- **Advantages:**
  1. Common size financial statement – income statement is a very useful tool for analyzing the financial position, particularly profitability.
  2. Common size statement is useful in comparing two or more periods or two or more companies when the production capacity is not the same.
  3. Components of cost of goods sold a company can be analyzed with the help of common size statement.
  4. The technique of analysis is useful when someone wish to compare one or more companies having differences in the organization’s size.

- **Limitations:**
  There are certain limitations of Common Size Income Statement, which are as follows:
  1. It shows the percentage of each item to the total period but not variations in respective terms from period to period.
  2. In calculating percentages, if the figure is negative, the percentages cannot be calculated and likewise, if the change is from or a zero balance in account, it is not possible to calculate the percentage, presenting the difficulties in common size analysis, therefore, the trends of the relationship are too complex for interpretation.
3. It provides information about the trend of individual item’s relationship to total but observations of these trends are not very useful because they are not definite norms for proportion of each item to total.

2.9.1.3 Trend Analysis

Trend analysis makes it easy to understand the changes in any item or a group of items over a period of time and to draw conclusion regarding the changes in data. For this purpose, a base year is chosen and the amount of that item relating to the base year is taken equal to one hundred and index numbers are calculated for other years based on the amount of that item in those years. It is a dynamic method of analysis showing the changes over a period of time. For proper trend analysis, the trend should be studied at least over a period of not less than five years. This method of analysis indicates the direction in which a concern is going and upon this basis for future can be made.

❖ UTILITY OF TREND ANALYSIS

This method of analyzing financial statement is more important due to its following merits:

1. **Summary Presentation:** The problem in this method is presented in a summary from as larger figures are converted into percentage or ratios which are comparatively more useful.

2. **Direction of Change:** The direction of changes can be even more clearly and easily represented by graphs and bar diagrams.

3. **Simple Method:** this method of analysis is simple and easy to present. The results obtained can easily be understood by a common man. More trained personnel’s are not required as an average person can analyses the data.

4. **No Possible of Errors:** in this method, the possibility of committing errors is reduced because results obtained from percentage changes in data can be verified from absolute changes.
2.9.1.4 Value Added Analysis

The concept of value added is considerably old. Value added is the wealth a reporting entity has been able to create through the collective effort of capital, management and employees. Value added is the wealth that a firm creates by its own efforts. Value added statement is the indicator of corporate performance for shareholders and stakeholders who contributes in the process of addition of value to product. The value added statements has several advantages. The value added statement is a good measure of the overall productivity of the firm and it is out of the value added that the firm rewards all interested parties. Value added based ratios are useful diagnostic and predictive tools. Value added statement is very good measure of the size and importance of an enterprise.

2.9.1.5 Fund Flow Analysis

In financial statements, balance sheet shows assets, liabilities and equity of the firm at a certain moment of time. Profit and loss account depicts operating results over a period of time. Both these financial statements do not depict the flows of funds and changes in the items of assets and liabilities between two dates. Hence, a funds flow of funds and statement is prepared to know the different sources of funds and their different uses. This funds flow statement is a summary report of financial operations of a business enterprise, in which it is explained, how business activities are financed and how the financial resources of the business are being used.

2.9.1.6 Cash Flow Analysis

In any business, it is essential to known the sources of cash and the items on which it is spent. Funds flow statement does not provide such information, because many items not relating to cash are included in funds flow statement. Therefore, to know about the flows of cash during an accounting period, a separate statement known as cash flow statement is prepared. Thus, cash flow statement is a statement of inflows (sources) and outflows (users) of cash and cash equivalents in an enterprise during a specified period of time. With this statement, the causes for variation in the cash balance between any two dates are interpreted.
2.9.1.7 Ratio Analysis:

Analysis of financial statement based on ratios is known as ratio analysis. Ratio analysis is a technique of presenting internal and external events affecting the business transaction relating to its operations, operating results and achievement of pre-determined goals and objectives of a business in brief and summary form. According to Belverd-E-Needless “Ratio guides or short cuts that are useful in evaluating the financial position and operations of a company and in comparing them with previous years or with other companies. The primary purpose of ratio is to point out areas for further investigations. They should be used in connection with a general understanding of the company and its environment.” In short ratio analysis is the process of determining and presenting is the relationship of items or group of items in the financial statement.

2.9.2 STATISTICAL TECHNIQUES

Use of statistical techniques has become a normal phenomenon in any type of analysis. There are various statistical techniques have been used in the financial analysis like Average/Mean, Standard Deviation, Index Numbers, Correlation and Regression Analysis, Analysis of Time Series, T-Test, F-Test, $\chi^2$ - Test or Chi-Square Test.

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.
REFERENCES