Chapter-II

Conceptual Framework of Financial performance

Introduction

In this world business units are working for providing good services and products with an objective of getting superior profit. Any organization is always try to earn noticeable profit for their shareholder. Business unit is not only connected with their shareholder, but so many different stake holders are connected with the company Viz. employee, customer, bank, other financial institutions, government, creditors, rating agencies, stoke exchange, brokers, society etc. And these stake holders are having their financial interest with business firm directly or indirectly. So it is mandatory to evaluate a financial performance of a business firm with proper tools for finding out actual financial position of particular business firm as well as industry.

While measuring financial performance of the business unit the most important factor becomes parameters taken at particular time. There are lots of experts who have given their opinion on parameter of financial performance of the bank. Even lots of research work are also available on this topic, which is being used with different parameters for measuring financial performance.
Financial performance is a photograph of financial aspects. It talks about what it owes and what a company owns. It is presenting holistic view about financial matters of the firm and also explains in what way business of particular firm has grown.

It is said that financial performance is the indicators of performance of management. The overall objective of a business is to earn satisfactory returns on the funds invested in it. Consistent with maintaining a sound financial position, performance analysis is done to examine the operational efficiency and financial efficiency. Strength and weakness of the any firm can be also measured by performance analysis. How firm is stable to generate long term return can be studied through performance analysis.

**Concept of Performance**

The significant of the word ‘Performance’ can be defined as ‘The functioning of an activity, with a view to get achievement by it’. Secondly, ‘Performance’ also means ‘the role play be the set up keeping in the mind the motive achieved by it’. In the reference of the banks, it is denoted by the way of development of banks. According to Erich L. Kohlar, “The Performance is a general term which is used to any organisation

The word performance has been used to accelerate the efficiency and effectiveness in the organisation. In order to achieve the predetermined goal, it integrates the efforts of human resource, marketing, natural and financial resources. (Robert Albans)
As per above definition, it shows that how excellently firm is performing to gain maximum out with minimum resources. Ultimately the important factors remain as achievement of objectives and the chief motives given for an organization.

In order to examine the performance, present activities is compared the past activities of the firm. Thus by comparing it is known that how far organisation is reached. General different accounting rations, social cost benefit cost and other aspects are compared.

Performance is nothing but the achievement of the goals. It is interpreted that performance means reaching to goal with efficiency and effectiveness. However different people have different meaning about performance, somebody believe that earning good return on capital employed means performance, somebody believe that achieving production target means performance, for somebody performance may mean satisfying needs of stakeholders. There is also a different between performance indicators and performance measures. A performance indicator means parameters of performance such as ROCE, EPS, Tobin’Q, EVA etc. Performance measures means cause and effect phenomena about any events or items.

**Objectives of Financial Analysis**

Main objective of the financial performance analysis is to analyses financial statements and past performance and future financial position. prediction f future can also been made with the help of financial analysis. Financial analysis look for pertinent standards of comparison to determine the result of their analysis are favorable or unfavorable. for this purpose comparisons are made with (A) general
rules of thumb indicators (B) past performance of the company and (C) Industry standard. Through financial analysis, vital information of the company can be accessed. Financial analysis helps to know the quality of the earnings. Earnings are said to be of high quality if they can be distributed in cash and are derived primarily from continuing operations that are not volatile from year to year.

Areas of Performance

There are different areas where the performance can be improved by effective assessment of different actions performed by a business organization in various areas of operations. Profitability, productivity, liquidity, working capital performance and measurement, fixed assets performance and disclosures, fund flow as well as free cash flow performance during the time period is among the areas which help in measuring the operational as well as social performance of an organisation irrespective of its size or type.

Concept of Appraisal

Appraisal is a smart application of technique to find out, to evaluate, to interpret, and then come to the conclusions. Researcher and experts do performance appraisal to do research in the field of commerce and management. Researcher compares to or more units and check the performance. Such performance analysis guides the stockholders.

Performance appraisal is a very precise and crux study of different measures followed by business firm in the operations.
The performance appraisal of bank is required frequently and regularly during fixed given period.

Performance appraisal off any business unit supports the manager to solved problems within the organizations. With the help of performance apraisal management's effectiveness to utilised resources is checked. Economic value added, profitability, financial position and liquidity position can also been know through performance appraisal. Strength and weakness is the main thing identified by the performance appraisal.

In order to analyse performance, the data of balance sheet and profit and loss account are arranged in proper order. Figures are presented in approximated two digits. Accounting tools and statistical techniques are used to analysed fundamentals of the company. Company has deferent segments and divisions, which can be measure through performance appraisal. Performance of the firm is measured and compare in the performance of the industries. in short, inter firm analysis is possible through performance appraisal.

As a concept performance appraisal is an exploiting tool for a business firm. As an exploiting tool, it cannot be taken as final product and final assessment which is vital part of whole process of appraisal. Though the performance appraisal is not fit to give a right reply to all questions of doubt it may come-up, but it will be definitely be able to point out the direction in which inquiries can be made. So, any sole effort will not be able to give the firm results of appraising business unit’s performance. So far the advancement of multi product and technology concerns, situations has become
more complex. While appraising the performance of various company and analyst must keep all these difference on finger tip.

**Advantages of performance appraisal**

Different stockholders like bankers, investors, government, creditors, management, employees, income tax department and trade union use performance appraisal. stack holders demand according to the performance of the firm.

**Management**

“Managers are responsible for efficiency, short term current and long term profit from business activities and effective growth of capital and other assets in the process.” (Erich A. Helfert) Management can come to know about the effectiveness and efficiency of its' plan and policies.

**Employees and Trade Unions**

There are three types of employees, past, current and future. Past employees are interested to the performance of the company because of the pension amounts depends on performance of the firm. current employees demand higher salary if performance is good. future aspirant employee join the company if company has bright future with good performance. Bargaining of trade union depends on the performance of the firm. Trade unions ask for facilities and higher salary if firm has good performance.
Investors

Investors are real enthroning part of any enterprise. With the help of study of the performance appraisal of the company, investors can come to know the profitability, productivity and efficiency of the unit. After having known these parameters of the firm, investors and share holders can ensure for their return and security of their invested capital.

Government

Performance appraisal of the firm is also done by the government. amount of income tax depends on the performance of the firm. higher the performance, higher amount of tax would be deposited to the government. Government can also check weather firm implements standards and norm lead down by the government through performance appraisal. Thus, Government can have direct checks and balances on firm through performance appraisal.

Other Groups

Other interested groups consists various agencies like media, economist, stock exchanges, authorities and tax consultants, active citizens who are interested in performance analysis of the firm and industry. Firm take inputs from the society and reciprocate something to the society. performance appraisal of the firm give the ideas about the activities being carried out for the society and social upliftment.
Performance appraisal supports to management for planning, controlling and decision making

Very useful information is provided to the management of the company by performance appraisal. Significant task such as planning, controlling and decision making need some analysed and interpreted information. such information is provided through performance appraisal. management needs both types of information qualitative and quantitative main goal of the management is to maximise the wealth of the stakeholders. to fulfil this need management has to be effective and efficient is using resources of the firm. Such a control is completely different from control over assets and property, as it looks at things from such angels- (1) Whatever work need to be done without the loss of time and (2) The cost limits included in the work remains within the estimated limits.

There are some important area like planning, controlling, decision making, expansion of projects, starting new projects, diversification of business and conglomerate. Management has to very careful to take decision for such vital area. Hence, manager rely on performance of the firm. Thus, without performance analysis, no management is able to take decision.

Process of Financial Appraisal

Through financial appraisal, analysis of liquidity, firmness, stability and profitability of the firm can be easily be predicted. The financial appraisal of a concern involves
the following steps: (i) Collection of financial data (ii) Classification and tabulation of financial data (iii) Application of appropriate techniques

(i) **Financial Data Collection:**

Financial data Collection of is the primary step in analyse the performance of the firm. According to, A collection of data is called a set of data, and single observation a data point. (R. I. Levin) Generally the collected data has been divided into two parts

(a) Primary data

(b) Secondary data.

(a) **Primary Data:**

Researcher collect primary data during the course of doing experiences in an experimental research but in case we do research of the descriptive type and perform surveys, weather sample surveys or census surveys, then we can obtain primary data either through observation or through direct communication with respondents in one form or another or through personal interviews.

(b) **Secondary Data:**

Secondary data means data that are already available i.e., they refer to the data which have already been collected and analysed by someone else. when the researcher utilised secondary data, than he has to look into various sources from where he can obtain them. In this case he is certainly not confronted with the problems that are usually associated with the collection of original data.
Secondary data may either be published data or unpublished data. Usually published data are available in

1. Government
2. Semi-government bodies
3. Trade associations
4. Trade journals
5. Periodicals
6. Magazines and Newspapers etc.

(ii) **Classification and Tabulation of Data:**

Financial appraisal is to classify and tabulate the financial data. Her sic and Pluck observe: "The statistician's first task is to reduce and simplify the detail into such a form that the salient features may be brought out, while still facilitating the interpretation of the assembled data. This procedure is known as classifying and tabulating the data." Financial data which have been obtained from secondary data sources are classified and tabulated in such a manner that the results may be easily interpreted. researcher has done all above mentioned procedures.

(iii) **Application of Appropriate Techniques:**

Many analysts have a favourite procedure for coming to some generalization about the firm being analyzed. Accounting ratio is used as an analytical tool to examine the financial position of the firm. The second factor, analytical tools used to assess the financial appraisal includes source and use of funds statement and the cash budget. There are certain factors which causes operating risk and financial risk. management
has to minimise both types of risk. technical risk is minimised with judicious use of
debt in capital structure where as operating risk is minimise with the help of cost
reduction techniques.

A. Ratio Analysis
B. Trend Analysis
C. Comparative Statement Analysis
D. Common Size Analysis
E. Funds Flow and Cash Flow Analysis

A. Ratio analysis

Ratio act as yardstick to evaluate, the financial condition and performance of a firm.
The main purpose of ratio analysis is to measure the past performance, and it is
compared to the budgeted or forecasted or standard industries ratio. It also helps in
projecting future trends. The ratio analysis is best accounting techniques to examine
financial condition of the business. accounting ratio is prepared on the basis of
figures taken from the balance sheet and profit and loss account. accounting ratio
analysis is universally accepted methods of performance analysis. proper analysis of
accounting ratio lead to meaning full conclusion which are helpful to decision maker.

With a help of this, the ratio or a group of ratios can be studied for the given period
of years with results and significant trends indicating raise decline or stability are
highlighted. Sometimes, the average value of ratio for past number of years can serve
the purpose of a standard against which to judge current performance.
The various ways to analyse ratio of the firm. 1- Inter firm comparison within the same industries 2- comparison of one firm of one industry with another firm of another industry. Thus, comparative analysis possible through accounting ratio. Position of the firm can be known with the help of their inter firm comparison.

Through ratio analysis performance of the management can be know weather management functions properly or not. Effectiveness of management functions like planning, organizing, staffing, directing, co-ordination, reporting and budgeting can be known. Management can meaningful decision on the basis of ratio analysis.

Types of Ratios

For the purpose of financial appraisal, financial ratios can be divided into four categories, viz., liquidity, debt-equity, profitability and coverage ratios. Whereas the first two types are computed from the balance sheet, the last two are obtained from the income statement and sometimes derived from both the income statement and balance sheet. It is important to note that no one ratio gives us sufficient information to evaluate financial condition and performance of a firm. It is only when one analyses a group of ratios that one is able to make reasonable judgments about the operational efficiency of a firm. It may further be noted that there are a large number of financial ratios. However, here the discussion is confined to the ratios which are of greater functional utility.
(I) **Liquidity Ratios:**

Liquidity ratios are used to judge a firm's ability to meet short-term obligations. Much insight can be obtained into the present cash solvency of the firm and its ability to remain solvent in the event of adversities. In the liquidity group, the most general and the most frequently used of these ratios are the current ratio, acid-test ratio, liquidity of receivables, duration of payables and liquidity of inventories etc.

(ii) **Debt - Equity Ratios:** For the purpose of analyzing the long-term liquidity of the firm (i.e. its ability to meet long-term obligations), several debt ratios may be used. The debt to net worth ratio is computed by simply dividing the total debt of the firm (including current liabilities) by its net worth.

(iii) **Profitability Ratios:**

Profitability ratios are of two types-those showing profitability in relation to sales, and those showing profitability in relation to investment. Together, these ratios give us indication of the firm's efficiency in operation.

(iv) **Coverage Ratios:**

Coverage ratios are designed to relate the financial charges of a firm to its ability to service them. One of the most traditional coverage ratios is the interest coverage ratio. Simply, it is the ratio of earnings before interest and taxes for a particular reporting period to the amount of interest charges for the period.
(v) **Activity Ratio:**

The activity of every enterprise is the sale of its product. Hence, the significance of every enterprise activity is judged in relation to its contribution towards sales. The generally used activity ratios are inventory turnover ratio, debtor’s turnover, fixed assets turnover, total assets turnover and expense ratio, etc. These ratios are simple to calculate. There is a tendency to overemploy them which leads to accumulation of mass data.

**Objectives of Ratio Analysis**

The true test of the profitability, productivity and financial strength of the business are the accounting ratios. The main objectives of this ratio analysis are as below.

- Measuring short and long term financial position of the company
- Judgment the operational efficiency of management
- Measurement of the profitability
- Assessing the efficiency of the business
- Helpful in budgeting and forecasting
- Facilitating comparative analysis of the performance

**Significance of Ratio Analysis**

1. **Clarification of Financial Statements**

   Stakeholders can clarify their doubts about financial statements with the Ratio analysis ratio analysis presents clear pictures about financial position of the firm.
2. **Inter-firm Comparison**

With the help of ratio analysis inter firm comparison is done. Inter firm comparison also presents the detailed financial positions about the firm to be compared with the firm within same industries. Inter firm comparison also explains strengths and weakness of the firm.

3. **Makes Intra-firm Comparison Possible**

Ratio analysis also makes possible comparison of the performance of the different divisions of the firm. The ratios are helpful in deciding about their efficiency or otherwise in the past and likely performance in the future.

4. **Planning**

In addition to preparing financial information for use by others, managers also use the information in many of their decisions. They need information for planning and controlling operations, for making special decision, and for formulating major plans and policies. Some of this information is available from the accounting systems. Managers use accounting information to evaluate potential investment projects. Since management is responsible for reporting enterprise performance to owners and others, it monitors the key financial indicator that appears in financial reports. Besides, management examines competition in the industry and makes financial comparisons of its performance against competitors' performance.

5. **Security analysis and advisers**

Investors and creditors seek the assistance of information specialists in assessing prospective returns. Equity and bond analysts, stockbrokers, and credit rating agencies offer a wide array of information services. Information specialists serve
the needs of investor by providing them with skilled analyses and interpretation of financial reports. Security analysts also collect information about firms through other means such as meetings with executives and field visits. Analysts' reports are use by securities firms to recommend to their clients whether to buy, sell or hold their investments.

**Limitations of Ratio Analysis**

**1. Difficulty in Comparison**

One serious limitation of ratio analysis arises out of the difficulty associated with their comparability. One technique that is employed is inter-firm comparison. But such comparisons are vitiated by different procedures adopted by various firms. The differences may relate to differences in the basis of inventory valuation, different depreciation methods, Estimated working life of assets, particularly of plant and equipment, Capitalisation of lease, amortisation of intangible assets like goodwill, patents

**2. Limitations of Financial Statements**

Accounting ratio is calculated on the basis of information sought from the balance sheet and profit and profit and loss account. Both the statements have some limitations. Therefore, accounting ratio calculated from the information derived from balance sheet and profit and loss account has also some limitations.

- **No ratio alone useful**

  Accounting ratio is meaningful to know financial position. It also suggest about the good thing and bad thing happened in the firm. ratio is nearly a mathematical
calculation. Therefore ratio itself does not tell anything but real interpretation lies with analyst. There are some events or matter or item needed to be analysed by the researcher. Therefore it is said that besides accounting ratio other techniques should be employed to have holistic judgement about the firm. Accounting ratio presents past situation prediction and forecast can be made on the basis of accounting ratios.

- **Window Dressing**
  Window dressing refers to the use of different techniques to cover low or poor performance. For example, a firm can borrow loan for a two-year period, which will increase cash balance. The loan can be repaid after the two years in limp sum. This will increase ratio, quick ratio and cash ratio. But this is window dressing.

- **Changes in Price**
  Changes in price reduce purchase power. Changes in result over time may show as if the firm has improved its business performance and position when in fact after adjusting for inflationary changes it will show the different picture.

- **Ratios does not consider Qualitative Factors**
  The factors are sources and commitment for material merchandise, and supplies the reputation and prestige of the company with the public, the credit rating of the company, efficiency of assets, employees loyalty and integration of the management and employees when interpreting the above factor are not considered.
B. Trend Analysis

For the purpose of financial appraisal of a business firm, an effective use of financial ratios can be done by observing the behaviour of ratios over period of time. As one of the Management tools, the importance of looking into trends and tendency of events between the financial statements prepared at different periods cannot be ignored because in long run investors keep an eye over them. Where the business was, where the business is and where the business will be, all these can be clearly examined through trend analysis. It helps in finding the years of fall down and arises. It directly shows whether the organizations capable of taking benefits from market changes or not. Significantly, trend analysis is a guide to follow the changes that occur in the business from time to time. When comparison is made between financial Statements of different period’s trend relationships occur. In other words, trend relationship signifies the ratio analysis and interpretation of the items of the comparative financial statements of different periods. For purposes of analysis and comparison the comparative figures of the financial statements are analyzed by calculating percentages. Usually, a particular past year is chosen as a base year and all items of the financial statements for the year are reckoned as 100. There is no doubt that expressing the figures in terms of percentages is a more practical approach for the analysis and interpretation of the financial data. Trend analysis can be prepared and presented in tabular form or in the form of graph or chart.

C. Comparative Statement Analysis

Comparisons are not always with others but some time with self too. Companies are responsible as well as accountable to the shareholders for their performances.
Balance sheet and income statement are historical rather than prophetic in nature. They present a record of the financial performance of business enterprises. Comparative balance sheets and comparative income statements exhibit trends; a clear understanding of these trends based upon sound ratio studies may convey some premonition regarding the immediate future of a particular business enterprise provided management policies do not change radically. The implications of the conduct of a business are reflected in its balance sheet in the form of an increase or decrease in the various current, fixed assets and liabilities including the proprietary equity or capital. These changes can be observed by a comparison of the balance sheets at the beginning and the end of a period and such observation of ten. Yields a considerable amount of information which is of value informing an opinion regarding the progress of the enterprise. Comparative balance sheet analysis is the study of the trend of the same items, groups of items, and computed items in two or more balance sheets of the same business enterprise on different dates, and the study of the trend of the proportions, computed from these figures as of the different dates. The great advantage in comparative analysis is that it portrays the trends of particular features of a business enterprise and of the enterprise as a whole.

D. Common Size Analysis

In addition to the financial ratio over time, often it is useful to express balance sheet and income statement items as percentage. The percentage can be related to totals, such as total assets or total sales, or to some base year, called common size analysis. Thus evaluation of trends in financial statement, percentages offer to the analyst an insight into the underlying movement of funds. While a good portion
of this insight is revealed by source-and-use of funds statements, a deeper and broader understanding of firm’s funds flow is possible when the analysis is extended to include the above considerations. The common size analysis is a vertical analysis depicting a static view of the qualitative relationship between the items of balance sheet and the profit and loss account. In the common size analysis, we express the various components of a balance sheet as percentage of a corporation's total assets. In addition, this can be done for the profit and loss account, but here items are related to sales. The gross and net profit margins, which we took up earlier, are examples of this type of expression, and this can be extended to all of the items on the profit and loss account or income statement. The expression of individual financial statement items as percentage of totals usually offers insight generally not yielded by a review of the raw figures.

E. Funds Flow and Cash Flow Analysis

One of the tools of financial analysis and planning deals with the analysis of fund flows of financial forecasting because every drop of fund should be utilised properly. A funds flow statement is a valuable aid to a financial manager or a creditor in evaluating the uses of funds by a firm and in determining how those uses are financed. In addition to studying past flows, the analyst can evaluate future flows by means of a funds statement based upon forecasts. A single mistake in fund flow investment or forecasting calculation will result in slashing financial performance as a whole. Such a statement provides an efficient method to the financial manager in assessing the firm's growth and its resulting financial needs, and in determining the best way to finance that needs. A cash budget involves a projection of future cash receipts and cash disbursements of the firm.
over a given interval of time. It reveals to the financial manager the timing and amount of expected cash inflows and outflows over the period studied. Within Information, he is better able to determine the future cash needs of the firm, plan for the financing of these needs, and to exercise control over the cash and liquidity of the firm.
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Chapter-III

Research methodology

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➢ Hypothesis of The Study

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