Volume : 3 | Issue : 5 | May 2014 • ISSN No 2277 - 8160

Research Paper | Commerce

Financial Performance Analysis

RATHOD MANISHA B

KEYWORDS :

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.

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 the achievement made by it'. In the context of the banks, it takes into account the way of their progress. The opinion of Robert Albans about performance is… "The word 'performance' is used to mean the efforts extended to achieve the targets efficiently and effectively. The achievement of targets involves the integrated use of human, financial and natural resources."

According to Erich L. Kohlar, "The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time; often with reference to past or projected costs efficiency, management responsibility or accountability or the like."

On the basis of the above definitions, it can be said that the word 'Performance' not only refers to the presentation of something but it also exhibits the quality and results achieved by the management of an enterprise. It takes into account the accomplishment of objectives and goals set for an enterprise keeping in view the comparison of the present success with the past.

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.

USEFULNESS OF FINANCIAL PERFORMANCE TO VARIOUS STAKEHOLDERS.

The analysis of financial performance is used by most of the business communities. They include the following.

1. Trade Creditors

The creditors provide goods / services on credit to the firm. They always face concern about recovery of their money. The creditors are always keen to know about the liquidity position of the firm. Thus, the financial performance parameters for them evolve around short term liquidity condition of the firm.

2. Suppliers of long term debt

The suppliers of long term debt provide finance for the on-going /expansion projects of the firm. The long term debt providers will always focus upon the solvency condition and survival of the business. Their confidence in the firm is of utmost importance as they are providing finance for a longer period of time.

Thus, for them the financial performance parameters evolve around the following:

i) Firm's profitability over a period of time.
ii) Firm's ability to generate cash - to be able to pay interest and
iii) Firm's ability to generate cash – to be able to repay the principal and
iv) The relationship between various sources of funds.

The long term creditors do consider the historical financial statements for the financial performance. However, the financial institutions also depend a lot on the projected financial statements indicating performance of the firm. Normally, the projections are prepared on the basis of expected capacity expansion, projected level of production \ service and market trends for the price movements of the raw material as well as finished goods.

3. Investors

Investors are the persons who have invested their money in the equity share capital of the firm. They are the most concerned community as they have also taken risk of investments – expecting a better financial performance of the firm. The investors' community always put more confidence in firm's steady growth in earnings. They judge the performance of the company by analyzing firm's present and future profitability, revenue stream and risk position.

4. Management

Management for a firm is always keen on financial analysis. It is ultimately the responsibility of the management to look at the most effective utilization of the resources. Management always tries to match effective balance between the asset liability management, effective risk management and short-term and long-term solvency condition.

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:

A. 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.

B. 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.

TECHNIQUES/TOOLS OF FINANCIAL PERFORMANCE ANALYSIS:

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

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 analysis.

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 analysis.

Correlation and Regression Analysis, Analysis of Time Series, Index Number, t-test, F-test, Chi-Square (X2) test, Diagrams & Graphs.

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.

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