

## A STUDY ON FINANCIAL PERFORMANCE ANALYSIS ON MEDOPHARM LTD, CHENNAI



### Finance

**KEYWORDS:** Financial analysis, ratio analysis, Medopharm Ltd Company.

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### ABSTRACT

*The thesis applies performance evaluation of pharmaceutical company in Chennai. It means evaluate how well the company performs. The main aim is achieved through ratio analysis of pharmaceutical Medopharm ltd. The main data collection from the annual financial reports on Medopharm ltd pharmaceutical company in 2013 to 2014. Different financial ratio are evaluated such liquidity ratios, asset management ratios, profitability ratios, market value ratios, debt management ratios and finally measure the best performance between two companies. The mathematical calculation was established for ratio analysis between companies from 2013-2014. It is most important factors for performance evaluation. The graphical analysis and comparisons are applied between two companies for measurement of all types of financial ratio analysis. Liquidity ratio is conveying the ability to repay short-term creditors and its total cash. It determines the performance of short term creditor of both pharmaceutical companies under the three categories such as current ratio, quick ratio and cash ratio. Asset management ratio is measurement how to effectively a company to use and controls its assets. It is also quantified into seven categories for both pharmaceutical companies such as account receivable turnover, average collection period, inventory turnover, account payable turnover in days, fixed asset turnover, total asset turnover. Profitability ratio is evaluate how well a company is performing by analyzing and how profit was earned relative to sales, total assets and net worth, for both pharmaceutical companies. Debt coverage ratio is performing that the property insufficient to collect their mortgage for both companies and market value is performed the stockholder to analyze their future market value of the stock market. Overall analyses are measurement the best one between Medopharm Ltd, Chennai.*

### INTRODUCTION:

The term 'financial performance analysis also known as analysis and interpretation of financial statements', refers to the process of determining financial strength and weaknesses of the firm by establishing strategic relationship between the items of the balance sheet, profit and loss account and other operative data.

"Financial performance analysis is a process of evaluating the relationship between component parts of a financial statement to obtain a better understanding of a firm's position and performance.

The purpose of financial analysis is to diagnose the information contained in financial statements so as to judge the profitability and financial soundness of the firm. Just like a doctor examines his patient by recording his body temperature, blood pressure etc. Before making his conclusion regarding the illness and before giving his treatment. A financial analyst analyses the financial statements with various tools of analysis before commenting upon the financial health or weaknesses of an enterprise.

The analysis and interpretation of financial statements is essential to bring out the mystery behind the figures in financial statements. Financial statements analysis is an attempt to determine the significance and meaning of the financial statement data so that forecast may be made of the future earnings, ability to pay interest and debt maturities (both current and long term) and profitability of a sound dividend policy. 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 results 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.

### REVIEW OF LITERATURE

Business theory draws heavily from Economics and Social sciences. Profitability and productivity are the two yardsticks against which the performance of any business organization is being measured.

Before the industrial revolution, business system was simple and the organizations were relatively small. The advent of mechanization, increase in the volume of business and invention of Company form of organization required that the financial transactions of the business need to be more scientific and organized. The science of book keeping, which was invented in 1494, was the obvious remedy to record, monitor and control the commercial transactions of various businesses.

Book keeping and Accounting are the fore runners of Finance. In fact, the science of financial management is based on Accounting and Economics. Accounting is defined as the art of recording and summarizing business transactions and of interpreting their effect on the affairs and activities of an economic unit. This definition given long back in 1955, is referring to management's use of accounting data for quantifying and appraising of the business activities. Another definition by a well known author is: Accounting deals almost exclusively with data that can be measured and reported in monetary terms.<sup>2</sup> Business is concerned with money, and the measure and reporting is through accounting mechanism. Accounting has often been called the language of business because people in the business world - owners, managers, bankers, brokers, lawyers, engineers, and investors use accounting terms and concepts to describe the events that make up the existence of business of every kind.

**Kennedy and McMullen.** Literature on Economics also has a reference to accounting and financial management. The aim of financial management has been linked with (1) the field of basic economics, and especially micro economics (use of scarce resource). (2) By examining the many and diverse activities and decisions which occupy financial managers.

**Long back (1957).** EF Donaldson referred to the importance of business and financial reporting. He highlighted that the economy depends on the business organizations for goods and services. United States believes in corporate world. The financial activities of business enterprises of production and sale are of utmost importance. In his well known publication (Corporate Finance, 1957) he has referred to all important aspects of business finance like organization structure, securities, production, capitalization, working capital, administration of income, expansion and combinations (mergers), reorganization and readjustments.

**Another authority has aptly said that:** Accounting is a systematic means of writing the economic history of an organization. Here there is a reference that the economic activity of any business enterprise is involving money and accounting is concerned with record keeping such monetary transactions of the business. The authority has referred that invention and growth of corporations (company form of organization) and need for keeping monetary records of growing and very large businesses were the basic reasons for the phenomenal development of accounting science and importance of financial statements as well as its analysis. This data was useful to the owners, government, customers, investors and the society. The important principles of verifiability, objectivity, consistency and comparability were developed, so that the statements become more reliable and useful. The authors have also mentioned that in the initial period of twentieth century, the following principles of management accounting were evolved and developed. (1) Relevance. (2) Flexibility. And (3) Timeliness.

Another definition by a well known author can also be referred : Accounting is score keeping, attention directing and problem solving.<sup>6</sup> This authority states that accounting system provides information for three broad objectives. (1) Internal reporting to managers for use in planning and control of current operations. (2) Internal reporting to managers for use in strategic planning, and (3) external reporting to owners, government and other outsiders. As a score keeping activity, all relevant data are generated by the system which becomes a guide for attention directing and problem solving in different areas like inventory, production, sales etc. The authors have referred to important aspects accounting principles, importance of Annual Reports, measurement of income, marginal costing and efficiency.

Robert Anthony, Professor of Accounting and Financial Control at Harvard University has written many authoritative books on accounting and financial management. He defines Accounting as a means of collecting, summarizing, analyzing and reporting in monetary terms, information about the business. This simple definition highlights the importance of accounting and financial information in the business enterprise. There is a reference to the following accounting principles and scope of the field of accounting and finance

#### NEED FOR STUDY

- Need of financial management study to diagnose the information contain in financial statement so as to judge the profitability and financial position of the firm.
- Financial analyst analyses the financial statements with various tools of analysis before commanding upon the financial health of the firm.
- Significance and meaning of the financial statements.

#### OBJECTIVES:

- To understand the financial statements of Medopharm ltd.
- To study the change in assets and liabilities of the company.
- To study the liquidity position of the firm.
- To study the financial health of the company using ratio analysis.
- To study the profitability of the company.
- To offer suggestions to the company.

#### SIGNIFICANCE OF FINANCIAL PERFORMANCE ANALYSIS

**Trade creditors:** interested in the liquidity of the firm (appraisal of firm's liquidity)

**Bond holders:** interested in the cash-flow ability of the firm (appraisal of firm's capital structure, the major sources and uses of funds, profitability over time, and projection of future profitability).

**Investors:** interested in present and expected future earnings as well as stability of these earnings (appraisal of firm's profitability and financial condition).

**Management:** interested in internal control, better financial condi-

tion and better performance (appraisal of firm's present financial condition, evaluation of opportunities in relation to this current position, return on investment provided by various assets of the company, etc)

#### RESEARCH METHODOLOGY

##### RESEARCH DESIGN

##### Sources of Data:

Data collected based on two sources:

1. Primary Data.
2. Secondary Data.

##### Secondary Data:

The secondary data are those which have already been collected by some other agency and

which have already been processed. The sources of secondary data are annual reports, browsing internet, through magazines.

1. It includes data gathered from the annual reports of Medopharm ltd..
2. Articles are collected from official website of Medopharm ltd.

##### Methodology Used:

Types Of Financial Statements Adopted:

Following Two Types of Financial Statements Are Commonly Used in Analyzing the Firm's Financial Position

- a. Balance Sheet.
- b. Income Statements

##### LIMITATIONS OF THE STUDY:

Only Interim Reports:

Only interim statements don't give a final picture of the concern. The data given in these statements is only approximate. The actual position can only be determined when the business is sold or liquidated.

Don't Give Extra Position:

The financial statements are expressed in monetary values, so they appear to give final and accurate position. The values of fixed assets in the balance sheet neither represent the value for which fixed assets can be sold nor the amount which will be required to replace these assets.

##### Historical Costs:

The financial statements are prepared on the basis of historical costs or original costs. The value of assets decreases with the passage of time current price changes are not taken into account. The statements are not prepared keeping in view the present economic conditions. The balance sheet loses the significance of being an index of current economic realities.

##### Act of non monetary factors Ignored:

There are certain factors which have a bearing on the financial position and operating results of the business but they don't become a part of these statements because they can't be measured in monetary terms. Such factors may include in the reputation of the management.

##### TOOLS OF FINANCIAL ANALYSIS OR TECHNIQUES OF ANALYSIS

- 1) Comparative Financial statements
- 2) Common size statement
- 3) Ratio Analysis
- 4) Trend Analysis

##### Comparative statements

Comparative financial statements are those statements which summaries and present related accounting data for number of years. It is an arrangement of the financial statements in such a manner that each element of the financial statement is comparable with same element of the financial statement of another period. Generally the financial statements of two periods are used for comparable study.

While pre-paring comparative statements one should keep in mind that the accounting principles, policies should be same. Any material change in such principles policies etc. comparative statements use less

A comparative statement provides the following.

1. Absolute change in amount or figures.
2. Absolute change in percentages.
3. Increase or decrease in figures and percentages.

**Advantages of comparative statements.**

1. It is helpful for inter period comparison.
2. It is helpful for inter firm comparison.
3. It is useful to study the trends of various elements of financial statements.

**Types of comparative statements.**

For the purpose of comparative analysis the financial statements are classified into 2 types namely,

- 1) Comparative balance sheet.
- 2) Comparative income statement

**1) Comparative balance sheet.**

Under this technique the balance sheet of two different dates or balance sheets of one firm to another firm may be used for comparative study. an item or group of item of one balance sheet is compared with the same item or group of item of another balance sheet. The comparative balance sheet is helpful to study the liquidity position, financial status, long term financial position etc. following are the steps for pre-paring comparative balance sheet. I) Redraft the balance sheet in vertical form.

- II) Pre-prepare two additional columns one for absolute change and another for percentage change.
- III) Study the trend (increase or decrease) and form the opinions.
- IV) Interpret the same.

**2) Comparative income statements:**

The comparative income statement is pre-paring to study growth rate in profitability, expenses, cost of goods sold etc. usually two years income statements are compared. For this purpose two additional columns are prepared for recording the absolute change and percentage change. The facts and figures in the financial statements i.e.( Balance sheet P&L a/c Reports & also some notes )can be transformed into meaningful and useful figures through a process called Analysis and Interpretation.

**ANALYSIS AND ITERPRETATION OF FINANCIAL STATEMENTS: 2.COMMON SIZE STATEMENTS:**

The financial statements are prepared with the absolute figures. Reading of absolute figures is not easy for quick grasping or understanding. Therefore they are converted into simple figures such as percentages to their totals for easy understandings. In case of balance sheet each item of the asset is expressed to the total assets and each liability to the total liability. Similarly in case of income statement each item of revenue or expenses are expressed to total sales.

When the financial statements of the same concern for several years are converted into percentages and presented for the comparative study are called comparative statements. The total size of the financial statement is fixed as 100.

All the items of the statements are expressed as percentages to the total.

**PROCEDURE:**

1. In case of Balance Sheet total assets and total liabilities are considered as 100.
2. Each item of asset is expressed in terms of percentage to the total assets. Similarly each liability to total liabilities.

3. In case of Income statement total sales is treated as 100.
4. Each item of revenue and expense is expressed as a percentage to the total sales.
5. Study of these percentages to establish relationship
6. Interpretation of the relationship in simple terms.

**TYPES OF COMMON SIZE STATEMENTS:**

1. Common Size Income Statement
2. Common Size Balance Sheet

**1. Common Size Income Statements:**

These statements are prepared to study the proportion of various elements of income statement items to the total sales revenue. The total sales items is considered Rs. 100 and all other items are expressed as a percentage to the total sales. In case of increase in sales tends to increase in the expenses directly related to sales. This kind of analysis helps to study the operational efficiency and financial performance of the concern.

**1. COMMON SIZE BALANCE SHEET:**

Common Size Balance Sheet means the size of the balance sheet of various years or items or firms is brought to a common figure. That is the totals of the assets and liabilities are considered as 100 and all the items of assets and liabilities are expressed in terms of percentages. The relationships are established with one item to its respective total and is compared with another years Balance Sheet.

Alternatively capital employed may also be considered as 100 and all other items of the balance sheet are expressed in percentages.

This kind of Analysis is helpful to study the Financial Position Liquidity Solvency etc. of the concern in various years

**3. TREND ANALYSIS:**

The trend analysis is another tool of financial analysis. Trend means a tendency. Trend analysis is review and appraisal of tendency in accounting variables. This analysis is more suitable for forecasting or budgeting. This analysis a series of trends information. It discloses the direction of items in the financial statement either upward, downward on constant over a period of time.

For the purpose of calculating trend percentages number of years financial statements are required. Trend ratio are calculated on the basis of base year information. The trend ratios on popular is statistics and are similar to index numbers. Which indicate the movement or fluctuation in various elements financial of statements of the business

**FORMULA FOR CALCULATION OF TREND PERCENTAGES.**

$$\frac{\text{Next years figures}}{\text{Base year figures}} \times 100$$

**RATIO ANALYSIS:**

**INTRODUCTION:**

The financial statement of a company contains a lot of information about the financial performance of the company. Financial statements mainly consist of the Balance Sheet and Profit and Loss Accounts. These statements give the overall picture of the company, but to analyse each aspect of business extensively, financial ratios are used. The Balance Sheet and the Statement of Income are essential, but they are only the starting point for successful financial management. Financial Ratio Analysis derived from Financial Statements analyses the success, failure, and progress of business.

Ratio Analysis is a very powerful analytical tool useful for measuring the performance of an organization. The ratio analysis concentrates on the interrelationship among the figures appearing in the mentioned financial statements. The ratio analysis helps the management to analyze the past performance of the firm and to make further projections

As the organization employs capital on fixed assets for the purpose of equipping itself with the required manufacturing facilities to produce goods and services which are saleable to the customers to earn revenue, it is necessary to measure the degree of success achieved in this bearing. This ratio establishes the relationship between the amount of sales revenue and the amount of capital employed on fixed assets.

Ratio refers to the establishment of relationship between any two inter-related variables. For example, both the amount of profit and the amount of sales revenue earned are inter-related as one is influenced by another.

Accounting Ratios shows the inter-relationships that exist among various accounting data. Accounting Ratios express the relationships, in the mathematical terms, between two or more items (of financial statements and others) which have a cause and effect relationship or which are connected with each other in one way or the other.

Since the Analysis and Interpretation of Financial Statements is made with the help of ratios it is called Ratio Analysis. The ratio analysis is, an effective tool or a device to diagnose the financial and operational diseases of business enterprises. The Ratio Analysis of Financial Statements stands for the purpose of arrangement of data, computation of ratios, interpretation of the ratios so computed and projections through ratios.

#### STEPS IN RATIO ANALYSIS:

- 1) Collect all the data required for computing the necessary ratios which in turn depends upon the purpose of calculating the ratios
- 2) With the help of above information, compute the necessary accounting ratios.
- 3) Compare the ratios so computed either with the ratios of the same company for the previous year/s.
- 4) Interpret the ratios in the light of the comparison, draw inferences, and prepare reports.

#### FINDINGS:

1. From the Income statement I found that the operating expenses increased compare to previous year. There is need of control on expenses.
2. From the comparative statement of 2012-13 we can find that there is decrease (.21%) in working capital compare to the year 2012. The current assets less but the current liabilities are more, so the company have to utilize funds properly i.e. there is a need of control on expenses
3. According to comparative Statements we come to know that the sales Gross profit are declining compare to previous year (2012) 2 4.64 to 4.45 to 4.93 to 5.62 from 2009 to 2013 so it is not favorable to the . . Company.
6. From the above financial analysis I found that in the present year the company is under loss.
7. The gross profit is found to be very low compare to previous year. The gross profit is declining. It reveals that the companies position is not appreciable
8. The trend analysis reveals that the sales declining year by year but there is slight fluctuation in costs.

#### SUGGESTIONS:

- The organization should adopt an appropriate capital structure.
- The company's debt-equity ratio is recorded more or less as 1.11 in the year 2012 and it is increased to 4.49 in the year 2014 (current year). The company should adopt a better debt equity mix in the future to control the fluctuations in returns.
- The company should control fluctuations in cash and bank balances as it impacts the current ratio of the company.
- The provisions are showing increasing trend which indicates risk of debtors. The firm should implement an effective credit management policy. It should utilize its idle funds by decreasing provisions.
- The company should control heavy increase of manufacturing & administration expenses as it is impacting the operating and net profit of company

#### CONCLUSION

The pharmaceutical industry as a whole represents an excellent investment opportunity for investors interested in long term growth and appreciation. Since pharmaceutical stocks are basically recession-resistant, investment in the pharmaceutical industry is an excellent way to diversify and insulate an investor's portfolio from the impact of the current slow recovery period. Furthermore, the pharmaceutical industry will provide growth in an economic period where growth is not expected.

Medopharm and Company represents an excellent investment for an investor who is interested in appreciation in value rather than dividend income. Medopharm will not provide the type of return desired by "get-rich-quick" types of investors. However, based on the stable growth that Medopharm has experienced and will, I believe, continue to experience in the

next few years Medopharm will provide long term investors with profitable returns and attractive yields. Just as the product lines of Medopharm and Company have loyal customers, I feel loyal investors are the ones who will profit most from an investment in Medopharm and Company.

Company represents an adequate investment opportunity for an investor who is interested in dividend income. Given the above average dividend payouts and the above average dividend yield, investing in medopharm may provide more income for an investor. However, those investors interested in capital appreciation would do better to invest in companies with more optimistic growth prospects.