PROFITABILITY AND OPERATIONAL EFFICIENCY

CHAPTER VII

7 PROFITABILITY AND OPERATIONAL EFFICIENCY

7.1 INTRODUCTION:

Management should be particularly interested in knowing financial strengths of the firm to make their best use and to be able to spot out financial weaknesses of the firm to take suitable corrective actions. The future plans of the firm should be laid down in view of the firm's financial strengths and weaknesses. Thus, financial analysis is the starting point for making plans, before using any sophisticated forecasting and planning procedures. Understanding the past is a prerequisite for anticipating the future.

Financial statements may refer to any formal and original statements which disclose financial information relating to any business concern. "Financial Statements are prepared for the purpose of presenting a periodical review or report on the progress by the management and deal with 1) the Status of investments in the business and 2) the results achieved during the period under review". The statement disclosing status of Investments is known as Balance Sheet and the statement showing the result is known as Profit and Loss Account.

Financial Statements contain a bundle of useful and valuable information regarding the profitability, position and future prospects of the business concerns. This information goes a long way in serving the interests of various parties interested in analysis and interpretation of these statements.

There has been a common feeling till recently that financial statement is meant only for shareholders and at most for government purposes. But it has now gradually been realized that financial statements can also be of great help to management. For proper execution of managerial functions, management needs correct and reliable information of various types. Besides management, financial statements are also of great significance for the banking company. Banks need analytical information regarding customers financial position especially ability to meet the obligations, solvency, credit standing and earning capacity.

They are interested to know not only the present position of the concerns but are equally interested to gather information in respect of future programmes and developmental projects. They attempt not only to analyze the credit standing but also make comprehensive analysis of customer's policies and plans. Information in respect of financial policy, assets distribution and position of liabilities etc. may be obtained from financial statements help banks in taking decisions regarding the extension of loans to their customers.

Financial data summarized in the form of financial statements are of outstanding significance to the various parties interested in and concerned with (directly or indirectly) the operation and the financial growth of business concern. These financial documents act as 'beckon light' to the business executives in chalking out of the various effective policies and in assessing the results of their efforts. In fact, these financial statements render a Yeoman's service to owners, suppliers, Government agencies employees, customers and even common public in their respective field of interest. It may, however, be observed that mere presentation of these statements does not serve the purpose of none of aforesaid parties in any way. In other words, the significance of these statements lies not in their preparation but in their analysis and interpretation. There is need for developing some scientific methods, like that one used in the preparation of these statements, through the use of which these accounting data be made to speak nothing but what is reality, when the user of these statements makes efforts in this direction that effort is called 'interpretation: In practice, such effort is also termed as 'criticism', 'examination' or 'analysis' though all these three are narrow as compared to interpretation. It would be more meaningful and convincing to call it as 'analysis and interpretation'.

Meaning and Process

"To interpret means to put the meaning of a statement in simple terms for the benefit of a person' – thus defines F. Wood in his work business Accounting Vol.II In any case, interpretation is a wider term and includes criticism examination and analysis.

An analysis of financial statements with the help of 'ratio' may be termed as 'ratio – analyses. It implies the process of computing, determining and presenting the relationship of items or group of items of financial statements. It also involves the comparison and interpretation of these ratios and the use of them for future projections.

Users of Financial Analysis

Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and the profit and loss account. Financial analysis can be undertaken by management of the firm, or by parties outside the firm, viz owners, creditors, investors and others. The nature of analysis will differ depending on the purpose of analyst.

- **Trade Creditors:**

  Are interested in firm's ability to meet their claims over a very short period of time. Their analysis will, therefore, confine to the evaluation of the firm's liquidity position.

- **Suppliers of long-term debt:**

  On the other hand, are concerned with the firm's long-term solvency and survival. They analyze the firm's profitability over time, its ability to generate cash to be able to pay interest and repay principal and the relationship between various sources of funds (capital structure relationships). Long-term creditors do analyze the historical financial statements, but they place more emphasis on the firm's projected, or pro-forma, financial statements, but they place more emphasis on the firm's projected, or pro-forma, financial statements to make analysis about its future solvency and profitability.

- **Investors:**

  Who have invested their money in the firm's financial structure to the extent it influences the firm's earnings ability and risk.

- **Management:**

  Of the firm would be interested in every aspect of the financial analysis. It is their overall responsibility to see that the resources of the firm are used most effectively and efficiently, and that the firm's financial condition is sound.

- **Nature of Ratio Analysis**

  Ratio analysis is a powerful tool of financial analysis. Ratio is defined as "the indicated quotient of two mathematical expressions" and as "relationship between two or more things". In financial analysis, ratio is used as a bench mark for evaluating the financial position and performance of a firm. The absolute accounting figures reported in the financial statements do not provided a meaningful understanding of the performance and financial position of a firm. An accounting figure conveys meaning when it is related to some other relevant information. Ratios help to summarize large quantities of financial data and to make qualitative judgment about the firm's financial performance. Ratio reflecting quantitative relationship helps to form a qualitative judgment. Such is the nature of all financial ratios.

Standards of Comparison

The ratio analysis involves comparison for a useful interpretation of the financial statements. A single ratio in itself does not indicate favorable or unfavorable condition. It should be compared with some standard. Standards of comparison may consist of Past ratios, i.e. Ratios calculated from the past financial statement of the same firm; Competitors' ratios, i.e. Ratios of some selected firms, especially the most progressive and successful competitor, at the same point in time.

Industry ratios, i.e. ratios of the industry to which the firm belongs; and Projected ratios, i.e. ratios developed using the projected, or pro-forma, financial statements of the same firm.

7.2 STUDY OF PERFORMANCE RATIOS AND CONCLUSIONS

Current Ratio

The difference between current assets and current liabilities is called Working Capital. It is commonly held that higher is the amount of working capital greater will be the liquidity of the business. Thus, the working capital may be considered as a measure of liquidity. It reflects the short-term solvency of concern. It is suggested that current assets should be at least twice of the current liabilities, i.e. the ideal current ratio is 2:1.

CURRENT RATIO = CURRENT ASSETS/CURRENT LIABILITIES

(Rs. In lack)

1998/99	1999/2000	2000/01	2001/02	2002/03
1117.55/696.36	2537.32/917.89	2931.93/1231.06	4188.36/1595.15	4075.87/2032.39
1.60:1	2.76:1	2.38:1	2.63:1	2:1

Higher the ratio better is the position. Above ratios indicate that concern can meet its current liabilities immediately as and when they are matured.

Debt Equity Ratio:

The financing of total assets of a business concern is done by owners equity (internal equity) as well as by outside debts (external equity). How much fund has been provided by the owners and how much by outsiders in the acquisition of total assets is a very significant factor affecting the long-term solvency position of the concern. Excessive external equity tends to cause insolvency. Thus, it becomes necessary that an ideal relationship must be established between total assets, owner's equity and outside debts.

The ideal Debt-Equity Ratio is 1:1. It measures the relative interest of owners and creditors in the concern. Lower the ratio better is the position and higher the ratio greater claim of creditors over the assets.

DEBT EQUITY RATIO = LONG TERM DEBTS/SHAREHOLDERS EQUITY

(Rs. In lack)

1998/99	1999/00	2000/01	2001/02	2002/03
483.89/688.96	999.5/848.38	918.78/1075.44	998.69/1507.75	696.58/1543.8
.70:1	1.18:1	.85:1	.66:1	.45:1

This ratio is satisfactory for all years except 1999/2000.

Debt to total Capital:

DEBT TO TOTAL CAPITAL = LONG TERM DEBTS/PERMANENT CAPITAL

1998/99	1999/00	2000/01	2001/02	2002/03
483.89/1489.18	999.53/2278.73	918.78/2471.13	998.69/3248.61	696.58/3881.59
.32:1	.44:1	.37:1	.31:1	.18:1

It shows the relation between long term debts and total capital. Higher the ratio greater is risk to creditors and shareholders.

Fixed Assets to Proprietors funds:

FIXED ASSETS TO PROPRIETORS FUNDS= FIXEDASSETS/PROPRAFUNDS*100

1998/99	1999/00	2000/01	2001/02	2002/03
1459/1124*100	1846/1418*100	2066/1785*100	2236/2798*100	2033/3528*100
124%	99%	115%	80%	58%

Current Assets to Proprietary Fund Ratio:

CAPFR= CURRENT ASSETS/PROPRIETORS FUNDS*100

1998/99	1999/00	2000/01	2001/02	2002/03
1117.55/1124.42	2537.32/1418.12	2931.93/1785.39	4188.36/2797.44	4075.87/3528.07
99.39%	178.92%	164.22%	149.72%	115.53%

Capital Gearing Ratio:

CGR= EQTY.SH.CAP.+RESV.FUND+PROFIT/PREF.SHCAP = LONGTERMLOANS

1998/99	1999/00	2000/01	2001/02	2002/03
688.96/483.89	848.38/999.53	1075.44/918.78	1507.75/998.69	1543.8/696.58
1.42:1	.85:1	1.11:1	1.51:1	2.22:1

This ratio is the analysis of the capital structure the inflationary conditions and during the period of depression.

Dividend per Share

It is calculated by dividing net profit after tax and preference share dividend by number of equity shares.

D..P.S.= Dividend to equity shareholders/ /No. of Equity Shares

1998/99	1999/00	2000/01	2001/02	2002/03
119.09/4077299	138.91/5161345	233.03/6133337	547.99/6709344	343.06/77027.99

Return on Equity Capital:

RETURN ON EQUITY CAPITAL= NET PROFIT/EQ.SH.CAPITAL *100

1998/99	1999/00	2000/01	2001/02	2002/03
119/408*100	139/516*100	233/613*100	548/671*100	343/770*100
29.20%	26.91%	37.99%	81.68%	44.54%

Non Performing Assets

As per Basle Accord- R.B.I. Deputy Governor Narsinha makes the provisions for N.P.A. This provisioning norm set by R.B.I. for non-performing assets are mandatory in nature and are essential for financial health of the Banking System.

This category of loan is directly impacting adversely on profit. More the N.P.A. more the provision and less the profit. NPA can act as an obstacle in development of a bank.

In the year 2001-2002 the bank had complied with guidelines of RBI and implemented the "One Time Settlement" (O.T.S.) Scheme. The Reserve Bank's OTS scheme is applied to the borrowers as well as the bank. With effect from 1st April 2002 interest will be recovered monthly as per fresh guidelines of Reserve Bank.

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Till the year 2001-02 the loan account was required to classify as "Non performing Assets". If the loan repayable amount remained in overdue for more than 180 days, but from the year 2002-03 RBI had brought down the limit to 90 days. The bank had made its recovery campaign rather strict, but it was necessary too. According to the Circular from Secretary, co-operation and textile industries, Maharashtra State Circular bank had implemented One Time Settlement Scheme. This scheme was applicable to 31st March 2000 NPA accounts.

BANKS MOVEMENT IN NPA'S

(Rs. In lack)

Year	Amt. of NPA's at the beginning of the year	Recovery during the year	Addition during the year	Amt. at the end of the year
2000/01	1500.45	400.44	1028.83	2128.84
2001/02	2128.84	493.08	449.81	2085.57
2002/03	2085.57	475.25	1124.93	2735.25

BANKS MOVEMENT IN PROVISION

A) Towards N.P.A.'s

(Rs. In lack)

Year	Amt. of NPA's at the beginning of the year	Additions during the yr.	Deduction during the yr.	Amt. at the end of yr.
2001/02	351.70	348.30	NIL	700.00
2002/03	700.00	125.00	NIL	825.00

B) Towards Standard Assets

(Rs. In lack)

Year	Amt. of NPA's at the beginning of the year	Additions during the year	Deduction during the year	Amt. at the end of the year
2001/02	40.00	1.02	NIL	41.02
2002/03	41.02	4.00	NIL	45.02

Standard NPA should be 9% of NPA's to Total Loans and advances for the year 2001/02 is 11.31% and that of 2002/03 13.35% which is a good signs.