P: ISSN NO.: 2321-290X RNI : UPBIL/2013/55327 VOL-6* ISSUE-4* (Part-1) December- 2018
E: ISSN NO.: 2349-980X **Shrinkhla Ek Shodhparak Vaicharik Patrika**

Financial Statement Analysis: A Brief Study

R.K. Nagrwal
Assistant Professor
Deptt. of ABST,
S.P.C.Govt.College,
Ajmer, Rajasthan, India.

Abstract

The success of every business enterprise is directly related to the competencies of business management. The business enterprise can, as a result, create variations of how to approach the new complex and changing situations of success in the market .Financial statements are records that can provide indications of the financial health of a company. Accurate financial records are necessary to keep track of financial warning signals such as inordinately high expenses, high levels of debt or a poor record of collecting bills. Public companies often have specific procedures for gathering, verifying and reporting financial information. Recent corporate scandals have placed greater scrutiny on the managers and corporate officers of publicly held firms. Privately held firms are not held to the same standard but often adhere to strict guidelines in order to increase the value of the firm and viability in case of sale.

Keywords: Financial Analysis, Company, Profit, Activity, Profitability, Liquidity, Indebtedness, Assets; Balance Sheet; Cash Flow; Fixed Costs; Liabilities

Introduction

The objective of this article is to provide basic knowledge about financial analysis ex-post and subsequently to evaluate the business subject progress in an area of activity, liquidity profitability and indebtedness, to reveal strengths and opportunities that the business subject should rely on. Financial statements are reports that show the financial position of a company. Recordkeeping is important in order to understand a company's value and to comply with various regulations and tax requirements. Accurate records allow companies to account for how money was spent and handled, what assets are owned and what debts are owed

Financial Analysis of The Selected Company

The financial situation of the business subject is considered to be a complex output of their whole performance. This output is presented through the ratio indicators of activity, profitability, liquidity, indebtedness and market value. (Baran and Pastýr, 2014, 6).

Financial analysis

A financial situation analysis is the foundation of the company's economic performance analysis and usually proceeds down to primary fields and results as effectively, efficiency, production capacity utilisation, supplement management and the like. Financial analysis detects weaknesses and strengths of the company, is the tool of "health" diagnostics and provides essential information to business management and to owners (Vlachynský, 2009, 369). The main purpose of financial analysis is to express assets and the financial position of the company and to prepare the inputs for internal management decision making. The complexity and continuous execution are the essential requirements of financial analysis (Hrdý, 2009, 118). Based on the objectives that have been set within this article, we'll provide more detail on the ratio indicators of profitability and liquidity.

Financial Analysis – Indicators of Activity

The activity indicators are used for business asset management, because they evaluate how effectively a business subject manages their assets. A business subject rates the commitment of individual items of the capital in certain forms of assets. If the business subject may have more assets than is appropriate, then unnecessary costs are incurred and the profit is adjusted.

The time of stock turnover testifies how many days does a stock turnover take. In other words, it indicates the time that is required for the transition of financial resources through production and products back into the form of money. There are some important formulas are given here

Stock turnover = average stock x 365/ revenues

Receivables turnover = average stock of short − term receivables x 365/revenues

Liabilities turnover = average stock of short − term liabilities x 365/revenues

Long − term asset turnover = revenue /average stock of long − term assets

Asset turnover = revenues / average stock of assets

Financial Analysis – Indicators of Profitability

The indicators of profitability, sometimes referred to as indicators of profit, return, profitability ratio, are designed as a ratio of the final effect achieved by business activity (output) to some comparative base (input) that can be on the side of assets as well as on the side of liabilities, or to another base.

Return on sales = net income x 100 /income

Operating return on sales = operating profit x 100 /income

Share of added value in revenues = added value x 100/income

Return on assets (ROA) = net profit x 100 / assets

Return on equity (ROE) = net profit x 100 / equity

Financial Analysis – Indicator of liquidity

Liquidity is a combination of all potential liquid resources that are available for the company to meet their payment obligations. According to professional literature solvency is defined as the readiness of the business subject to undertake payment of their obligations at the time of their reimbursement and therefore is one of the basic conditions of the company's successful existence.Liquidity of the 1 st level shows, how many times the short-term financial assets (current assets) covers the short-term obligations of the business subject.

1^{st} level liquidity = current financial/ assets short − term foreign sources

For coverage of the business subject's short-term obligations, can be used the immediate financial resources that are available on bank accounts and in treasury as well as expected financial resources of not yet refunded short-term obligations. This relationship gives us liquidity of the 2^{nd} level.

2^{nd} level liquidity = current financial assets + short − term obligations / short − term foreign sources

Liquidity of the 3 rd level determines the ability of the company to pay their obligations to short-term borrowed capital through the current assets. This means that the company does have enough short-term resources to manage their regular operation.

3rd level liquidity = current assets/ short − term foreign sources

Financial analysis - Horizontal liquidity

A very important task within liquidity analysis is horizontal liquidity. The horizontal liquidity examines the mutual context and relations among items of assets and items of capital in financial statements- the balance sheet.

Golden Statistic Rule

The golden statistic rule requires that the source coverage of long-term assets (LA) is long-term sources coverage (LC). This means that the financial resources won't be available for shorter than the commitment of equity participation, for which this serves. A relationship between long-term assets and long- term sources can be in this case threefold (Kotulič, 2010):

1. LC < LC, or LA – LC < 0 => company is pre-financed,
2. LA > LC, or LA – LC > 0 => company is under-financed,
3. LA = LC, or LA – LC = 0 => company assets are optimally financed.

The current assets (CA) should be covered mostly by current sources (CS). The difference between CA and CS is called a NET working capital.

NET working capital

The net working capital is an indicator, which reconstructs part of the current assets (current assets) that is financed by long-term financial resources, either by equity or by borrowed capital.

NWC = current assets – short-term obligations

Financial Analysis - Indicators of Indebtedness

The term of indebtedness expresses the fact that the company finances their assets by foreign sources. By using foreign sources the company affects both the profitability of shareholders as well as the business risk

Total indebtedness=foreign sources x 100/assets

Coefficient of self−financing=equity x 100/ assets

Insolvency=short−term liabilities x 100/short−term receivables

Credit indebtedness=bank loans and overdrafts x 100 / foreign sources

Interest coverage=economic result before tax+ interest expense/ interest expense

Indebtedness flow=foreign sources /cash flow

Proposal for Improvements of Monitored Business Subject´S Selected Ratio Indicators of Financial-Economic Analysis

The activity ratio indicator of the monitored business subject

At the time of stock turnover we propose continuous stock monitoring to prevent the adversely high inventory. As well in the future we propose some optimisation of stock flow management in relation to production or its improved procurement from various suppliers, storage and use through a precise time system, motion planning in parallel with production needs.

The time of short-term receivables collection can enable further possible business development within fair trade and good customer-supplier relationships. I see the possibility of improvement or the volume and frequency of short- term receivables reduction as well as the time period of their reimbursement in the incentives of customers themselves through the provision of cash discount, price discounts for payment before the due date of the relevant receivable and thereby ensuring stabilisation or receivables turnover time reduction.

A further possibility to decrease the short-term receivables collection is to introduce a strict internal control system in issuing e.g. customer invoices in the form of rescheduling.

To ensure the timely payment of receivables of less responsible customers it is necessary to apply the reminders notice mechanism or sanctioning for non-compliance of contractual conditions of payment.

In the case of receivables management improvement the acquired financial sources could be used to reduce the size as well as the short-term liabilities time period of the business subject from trade by invoice reimbursement from their suppliers to maturity or sooner, or reducing the need to use short-term bank loans.

The long- term asset turnover has significant different values, thus I recommend that the business subject uses their long-term assets more effectively.

By decreasing the stock turnover time period ensures the greater production flexibility, because the high volume of stocks binds unnecessary finances that could be invested into other business areas e.g. into its development, modernisation and etc.

By reducing the short- term receivables time period through using a cash discount or price discounts for payment before maturity of the receivable will lead to a decline of unliquidated short-term receivables in the business subject. This allows further use of cashed financial sources e.g. the earlier payment of short-term liabilities of the business subject or reducing the need to use short-term bank loans. In the supplier this motivational tool can induce the willingness on his part to closer cooperate under favourable conditions. The introduction of an internal control system in issuing of customer invoices timeliness and excellence may ensured this.

The profitability ratio indicator of the monitored business subject

We can state that the results of profitability indicators have positive values. That means the business subject achieves continuous profit. Almost all these indicators in a period of six years achieved within the recent two years a slight downward trend. The interests of the business subject is to stabilise or to increase these values. Therefore a continuous monitoring of indicators of sales and profit is required, to increase the level of these indicators. These objectives can be achieved by the following measures:

A. By a flexible pricing policy,
(a) by improving the efficiency of the marketing mix,
(b) by efforts to win new customers and cheaper suppliers,
(c) by investing in financial market products for example in bonds and funds.

On the other hand, to prevent further decline of the business subject's profit, it is required to secure the economy and efficiency by optimisation of costs and by individual asset items utilisation. It is mainly the following cost items:

B. The cost of material and energy consumption,
(a) by applying new production technologies and the use of new or innovated technology,
(b) by improving work organisation and production management in the form of production process harmonisation, production capacity utilisation,
(c) by raising the educational level of employees,

C. The reduction of personnel costs,
(a) by standardised work of production employees,
(b) by optimisation of overhead employees,
(c) by optimisation of technical and administrative employees.

Following the introduction of design measures there is a premise of the business subjects economic result increase for the accounting period as well as the increase of the revenue indicators. The business subject will accomplish a stabilised position on the market by obtaining new and more advantageous financial relationships. As well higher profitability and more efficient capital utilisation for business subject's owners will be accomplished by realisation of the mentioned measures

2.1The ratio and differential liquidity indicator of the monitored business subject

Three ways of this value reduction are proposed:

(a) by increase of their fixed resources of settlement by raising their equity through basic capital increase in the form of share issue,
(b) by bond issue,
(c) by increase of their external sources through obtaining of long-term bank loan.

Within the monitored business subject the current assets exceeds short-term obligations. The exception of this is the latest year, therefore we propose towards the future period to increase the business subject's liquidity by increasing the volume of their current financial assets

(a) (a)by reducing the time of debt collection from business relations (by discount, by monitoring, by mechanism of reminders, by penalties),
(b) by reduction of supplement turnover time (better supplement management),
(c) by advance charge on customised production,
(d) by sale of surplus assets, but this asset change could result in a lower ability for further business activities development in the future.

After the implementation of submitted proposals for increasing the business subject's liquidity, there is the premise of a business subject's solvency increase while the conditions for balanced development are created. The business subject will have the necessary financial resources and will be able to reimburse on time their short-term obligations with their financial resources as well as be able to use them for further development.

The indebtedness ratio indicator of the monitored business subject

Undertaking in relation to business activity, the business subject has acceptable values of total indebtedness as well as the self-financing coefficient, thus I do recommend to monitor, maintain and not to exceed this state or this indebtedness rate.

Regarding the insolvency indicator the business subject is primarily located in insolvency, therefore I recommend that the business subject shall try to reduce the level of a short-term liabilities.

After the incorporation of measures the level of equity and foreign capital will stabilise and the overall stability will be ensured. The business subject will seem more attractive in the provision of loans as well as in individual investments.

Conclusion

In the present turbulent competitive environment the financial analysis is an essential part of monitoring the business subject and is an important tool to support the decision making of various stakeholder groups. Also it provides a picture or feedback about the whole condition of business subject and their development and about a condition of individual operation areas. This analysis is able to identify factors that with the largest stake have caused undesirable results within the business subject. Through prediction models of financial-economic analysis the business subject is able to predict their future development and possible option for bankruptcy.

Among the benefits of this article belongs financial-economic analysis focused on the business subject's ratio indicators of activity, profitability, liquidity and indebtedness itself.

Related proposals mentioned in this article for weaknesses elimination which were found by financial analysis are focused on practical use in the business subject's experience.

References

BARAN, D. 2001. Management Analyst. Bratislava: ES STU.

BARAN, D. et al. 2005. Application of business process reengineering in the company practice, Bratislava: ES STU.

BARAN, D. 2008. Application of controlling in business practice. Bratislava: ES STU.

BARAN, D. et al. 2011. Financial analysis of the company I., EPI Kunovice.

BARAN, D., PASTYR, A. 2014. The business subject analysis by selected ratio indicators. Bratislava: Proceedings of the Scientific Papers in Economic and Managerial Challenges of Business Environment, COMENIUS UNIVERSITY IN BRATISLAVA, 5-18 pp.

BARAN, D. 2015. Controlling. Bratislava. ES STU.

ČERNÁ, A. 1997. Financial analysis: Prague: Bank Institute plc.

FARKAŠOVÁ, E., DŽUPKA, P. 2007. Economic analysis of the company. Košice: TU.