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A Significance of Financial Ratio Analysis in Decisions Making: A Case Study of Kicons Pvt. Ltd.

Salih Rasul Agala[1] Prin. K. D. Jadhav[2] and Shivaji Borhade[2]

[1]Koya Technical Institute, Iraq
[2]Bharati Vidyapeeth University, Pune (India)

Abstract:

Purpose: The purpose of the study is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment of time as in the case of a balance sheet, or may reveal a series of activities over a given period of time, as in the case of an income statement.

Design/Methodology/Approach: Random sample of 40 members from Kicons Pvt. Ltd. were selected. The opinions of sample members have been collected through questionnaires. The questionnaires were made and given to the management staff of Kicons Pvt. Limited. Secondary data were collected from the reference books, published journals, annual reports etc. The data, both primary and secondary have been tabulated in a suitable sheet prepared for the purpose. Analyzing and interpreting the collected data, conclusion has been drawn.

Findings: Ratio analysis helps the analyst to make quantitative judgment with regard to concerns financial position and performance.

Research Limitations/Implications: The study is totally based on the opinions of the sample selected from Kicons Pvt. Ltd. This study is a case study of Kicons Pvt. Ltd. therefore outcomes of the study may not be generalised.

Practical Implication: The study is totally based on the sample opinions of the sample unit. The scope of this study is limited to the Kicons Pvt. Ltd.

Originality/Value: Ratio analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account.

Key Words: Financial ratio, Financial statements, Decision making,
Paper Type: Research paper

Introduction

Financial statements are indicators of the two significant factors profitability and financial soundness, analysis and interpretation of financial statements, therefore, refers to such a treatment of the information contained in income statement and the balance sheet.

A Ratio is a quantitative equation between two figures done mathematically. In order to be meaningful, the two figures of the ratio must be related. A ratio is a tool used by all interested parties to quantify the risk element before taking a decision. They use one figure as numerator and another as denominator according to their purpose of analysis. (Chatterjee, 2011 : p. 149)[1] .

A 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. Hence a meaningful and useful relationship may be established between these two. It is because of the reason that the amount or the rate of profit is influenced by the sales revenue. Since the analysis and interpretation of financial statement is made with the help of ratio, it is called 'Ratio Analysis'. The ratio analysis is, therefore an effective tool or a device to diagnose the financial and operational diseases of business enterprises. The ratio analysis of financial statement stands for the process of arrangement of data, computation of ratios and interpretation of the ratios computed and projected**.** (Igben, 1999: p. 423)[2] .

Ratios are guides or shortcuts that are useful in evaluating the financial position and operations of a company and in comparing them to previous years or to other companies. The primary purpose of ratio is to point out areas for further investigation. They should be used in connection with a general understanding of the company and its environment. (Kothari and Godha, 2010: p 353)[3].

Managers usually follow a decision model for choosing among different course of action. A decision model is a formal method of making a choice, and it often involves both quantitative and qualitative analyses. Management accounting works with managers by analyzing and presenting relevant data to guide decision. (Horngren, et al 2009: p.441)[4]

Annual reporting includes a section referred to as management's discussion and analysis, which is a discussion by management of their company's operating results, liquidity, solvency, important developments during the periods covered by the primary financial statements and the possible impact on future financial statements and the possible impact on future financial statement of known trends and events. Also is the potential impact of new accounting standards on the company's financial statement. (Anthony, et al 2007: p.424)[5].

Review of Literature

In financial analysis of the Russian forest product companies, the study applies financial analysis and assesses the financial performance evaluate how well the companies perform. The goal is achieved through implementation of different financial analysing tools and techniques, mainly financial ratio analysis. Different financial measures are evaluated. Furthermore, comparisons are made between companies, their past and expected future development is analysed and compared with the economy in general. Ratio analysis showed as well that all studied companies had problems with the absolute liquidity. (Stanislav, 2008: p12)[5].

Kabera tried to find out the degree to which accounting ratios can be used to draw conclusion upon which decision are made. The research specifically had to identify different ratios used in financial statement analysis in decision making, also the role of financial ratios analysis in decision making had to be indicated and lastly the use and limitation of accounting ratios. This study revealed that the accounting ratios are indispensable in reasonable decision making. Generally, some of business entities use accounting ratios in a proper way. The use of accounting ratios in financial statements analysis varies according to the decision to be made by those who use them. Different managers use different analytical tools and techniques depending on the objectives of the analyst and nature of the business, it was further found out that the accounting ratios reduce the long array of financial statement in decision making. (Kabera, 2009:p 44)[6].

Analysis and interpretation of financial statements is an important tool in assessing company's performance. It reveals the strengths and weaknesses of a firm. It helps the clients to decide in which firm the risk is less or in which one they should invest so that maximum benefit can be earned. It is known that investing in any company involves a lot of risk. So before putting up money in any company one must have thorough knowledge about its past records and performances. Based on the data available the trend of the company can be predicted in near future. This project mainly focuses on the basics of different types of financial statements. Balance sheet and profit and loss statements of five different coal and non coal mining companies have been studied. (Sudip, 2010: p127)[7].

The researcher concludes by saying that financial statement plays a vital role in investment decision making; for instance, where companies invest hundreds of billions of naira every year in fixed assets. By their nature, these investment decisions have the potential to affect the firm's fortunes over several years. For a good decision can boost earning sharply and dramatically increase the value of the firm. This financial information can be subjected to various scrutiny and analysis depending on the investors before making their investment decisions. This is quickly appreciated in the banking sector as one of the major criterions is the demand from their borrowers at the financial statements of the concern for various years. This is subjected to their analysis and interpretations before they can go ahead in the loan negotiation concerning any company. Hence, it is opined that companies should try as much as possible to posit financial statements that reflects a true and fair view of what is proposed to represent as a way of appreciating their companies the more. (Amedu, 2012:p95)[8].

The aim of the study was met by comparing the risk of different companies, their rate of return, future trends and their strengths and weaknesses. Several comparison models used in this study can be adopted by anyone to rate a company's performance with the other companies. Although, the four automotive companies have been used for the research, the aim of the research is not to choose among them the best one for the purpose of investment. The impact of an individual component of the financial statement in the company's overall performance has also been revealed in the empirical framework. Another feature of this study is the ratio analysis of the companies. The impact of financial ratio over the company's overall performance was also discussed and verified in the study. (Raju, 2012: p67)[9].

Accounting constitutes a frame for presenting information which makes it an assistant tool, whereas economics take this information and make monetary decision making upon it. Management accounting techniques such as performance measures, budgets and costing techniques are specific types of calculation methods indicating the role as means. The information, that management accounting techniques present, is often related to management accounting itself, especially in the discussion of efficiency, savings and productivity. (Margit, 2012: p267)[10].

Problem of the Study

The financial statements is to provide information about the financial position performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements are prepared primarily for decision making. Ratio analysis helps in making decision from the information provided in these financial statements. There are various methods or techniques used in analyzing financial statements. The ratio analysis is one of the most powerful tools of financial analysis. It is with the help of ratios that the financial statement can be analyzed more clearly and decision made from such analysis.

Significance of the Study

The significance of this study is that on its completion, the following benefits will be derived:

1. The study will help management of Kicons Pvt. Ltd., Pune and others to know how ratio analysis can help them to understand the financial contain in financial statements and enhance their business decisions.
2. The findings of the research and the supportive reference materials will be of immense help to students in tertiary institutions and other researchers to investigate further in the area of study.
3. It is hoped that the result of the research will facilitate optimal business decisions when the recommendations are complied with.

Objectives of the Study

The objectives of the study are:

1. To facilitate the decisions making by the management
2. To show how ratio analysis aids business decisions
3. To examine the use of financial ratios for knowing profitability, financial position and operating efficiency of an enterprise.
4. To suggest suitable ways to enhance efficient use of ratio analysis in decision making.

Hypotheses

1. Is the ratio analysis simplifies the financial data which becomes easy to understand the financial statements?
2. Is ratio analysis useful in evaluating and predicting the performance of a business as well as intensifying areas that regret improvement?
3. Are there obstacles that affect the proper use of ratio analysis in business decisions?
4. Is accounting ratio help the managerial persons in their decision making task?
5. Is ratio analysis useful to management, investors, shareholders and creditors in their business divisions?

Data Collection

Both the primary and secondary sources are used for collecting the required data. The primary data were collected by questionnaires with a lot of questions related to different aspects of impact and importance of ratio analysis on financial performance. The questionnaires were sent to financial and managerial staff of Kicons Pvt. Ltd. Along with the primary data, the researchers have collected secondary data from various sources like reference books, theses, previous studies, journals, magazines.

Sample Selection

This study is related to the analysis of the statement and the balance sheet by means of financial ratio. Therefore, researchers have decided to consider a case study of Kicons Pvt. Ltd. The respondents were selected from the sample unit for the study.

Results and Discussion

In this part, the discussion is held on statistical analysis regarding the data provided by the respondents.

Table 1: Response Rate of the Questionnaires

Response	Frequency/ Rate of Mgt Staff	Frequency/ Rate of Non Mgt Staff
Distributed questionnaires	30	10
Returned questionnaires	30	8
Not returned questionnaires	0	2
Response rate	95%	5%

Table 2: Questionnaire Distributions and Collection

Questionnaires	Managerial Staff	Non-Managerial Staff	Total
Administered	30 (75%)	10 (25%)	40 (100%)
Returned	30 (75%)	8 (20%)	38 (95%)
Non Returned	0	2 (5%)	2 (5%)

As shown in the table above, 38 (95%) of the total number of questionnaires distributed were returned, while 2 (5%) were not returned.

The questionnaire used in the data collection had 11 questions. The first 2 questions (question 1 and 2) relate to the gender and staff positions of the respondents respectively. The remaining question 8 and 11 were used to achieve the objectives of the study.

However, as stated earlier, only questions that are must relevant to the research questions were presented and analyzed. In these regards, the response given to question 4 to 11 were presented and analyzed, as well as used to draw the conclusions.

Table 3: Highest Qualification Level Obtained

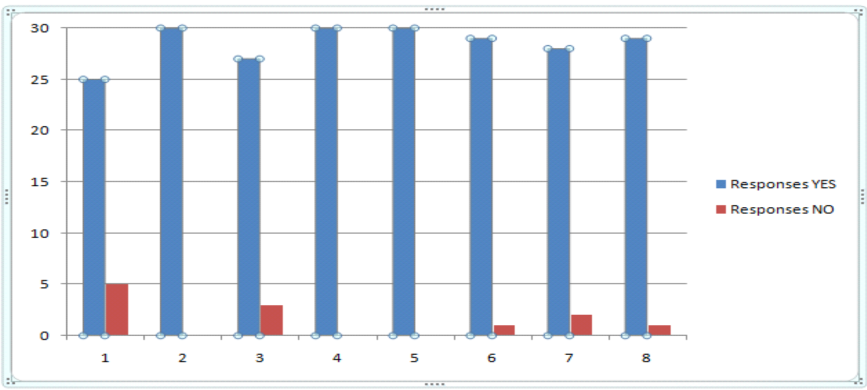
Level	**Management staff**		**Non Management staff**		**Total**
	No	Percentage	No	Percentage	
M.Sc.	5	13.15%	0	0%	13.15%
B. Sc.	5	13.15%	0	0%	13.15%
Hnd	10	26.3%	4	10.55%	36.85%
Ond	5	13.15%	2	5.275%	18.425%
O level	5	13.15%	2	5.275%	18.425%
Total	30	78.9%	8	21.1%	100%

The above table indicates the highest qualification obtained by all the staff. It shows that 5 (13.15%) out of 30 (78.9%) are M. Sc. holders, 5 (13.15%) out of 30 (78.9%) of the management staff are B. Sc. holders, 2 (10%) out of 30 (78.9%) of the management staff are HND holders10 (26.3%) out of 30 (78.9%),Ond 5 (13.15%) out of 30 (78.9%),O level 5 (13.15%) out of 30 (78.9%), So far as the non-management staff is concerned, 4 (10.55%) out of 8 (21.1%) are HND holders, 2 (5.275%) out of 8 (5.275%) are OND holders, while 2 (5.275%) of the remaining are O level holders.

Table 4: Number of Responses of Management Staff

Sr.	Questions	Responses Yes	Responses No
1	Do you believe that financial statements- income statement and balance sheet are effective ways of communicating financial information?	25 (83.3%)	5 (16.7%)
2	Is ratio analysis used by your firm as a decision making tool?	30 (100%)	0
3	Do you agree that ratio analysis facilitates proper understanding of information contained in financial statements?	27 (90%)	3 (10%)
4	Do you think that ratio analysis is useful to management, investing shareholders and creditors in their business decisions?	30 (100%)	0
5	Do you think that financial ratios are useful in evaluating and predicting the performance of a business as well as certifying areas that require improvement?	30 (100%)	0
6	Do you agree with the saying that ratio analysis helps it's to ask the right questions but do not provide answers unless the right comparative standards and techniques are used?	29 (96.7%)	1 (3.3%)
7	Are there obstacles to the proper use of ratio analysis in your business?	28 (93.3%)	2 (6.7%)
8	Does financial retro helps to unravel the mass of truth hidden in financial statement?	29 (96.7%)	1 (3.3%)

Figure 1 Number of Responses of Management Staff



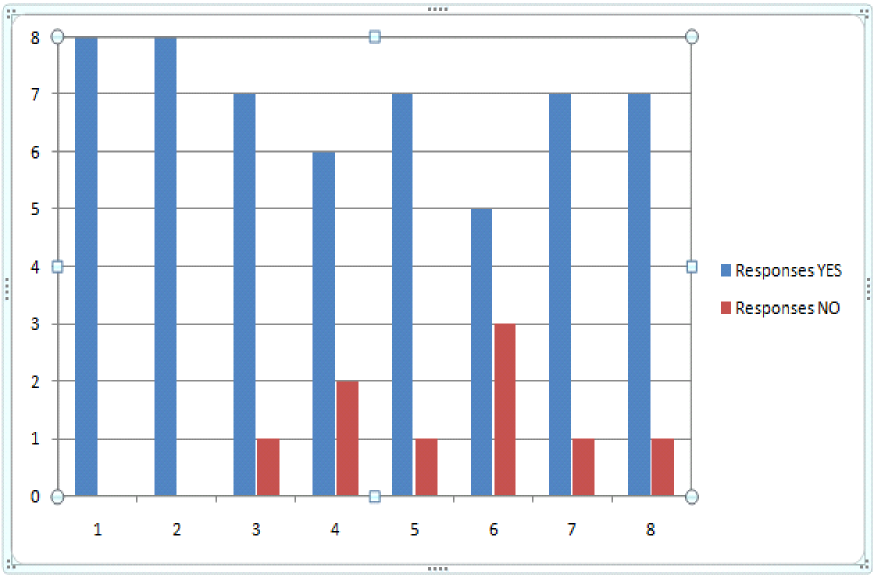
As shown in the table above of management staff that-

1. Do you believe that financial statements- income statement and balance sheet are effective ways of communicating financial information?
   - 83.3% of respondents agreed that the financial statements- income statement and balance sheet are effective ways of communicating financial information while 16.7% not agreed.
2. Is Ratio Analysis used by your firm as a decision making tool?
   - 100% of respondents agreed that the ratio analysis used by your firm as a decision making tool.
3. Do you agree that ratio analysis facilitates proper understanding of information contained in financial statements?
   - 90% of respondents agreed that the ratio analysis facilitates proper understanding of information contained in financial statements.
4. Do you think that ratio analysis is useful to management, investing shareholders and creditors in their business decisions?
   - Cent per cent respondents agreed that the ratio analysis is useful to management, investing shareholders and creditors in their business decisions.
5. Do you think that financial ratios are useful in evaluating and predicting the performance of a business as well as certifying areas that require improvement?
   - 100% of respondents agreed that the financial ratios are useful in evaluating and predating the performance of a business as well as certifying areas that require improvement.
6. Do you agree with the saying that ratio analysis helps to ask the right questions but do not provide answers unless the right comparative standards and techniques are used?
   - 96.7% of respondents agreed that the ratio analysis helps to ask the right questions but do not provide answers unless the right comparative standards and techniques are used and 3.3% not agree.
7. Are there obstacles to the proper use of ratio analysis in your business?
   - 93.3% of respondents agreed that the proper use of rotor analysis in your business clerisies and 6.7% not agree.
8. Does financial ratio helps to unravel the mass of truth hidden in financial statement?
   - 96.7% of respondents agreed that the financial retro helps to unravel the mass of truth hidden in financial statement and 3.3% not agree.

Table 5: Number of Responses of Non-Management Staff

Sr.	Questions	Responses Yes	Responses No
1	Do you believe that financial statements- income statement and balance sheet are effective ways of communicating financial information?	8 (100%)	0
2	Is Ratio Analysis used by your firm as a decision making tool?	8 (100%)	0
3	Do you agree that ratio analysis facilitates proper understanding of information contained in financial statements?	7 (87.5%)	1 (12.5%)
4	Do you think that Ratio Analysis is useful to management, investing shareholders and creditors in their business decisions?	6 (75%)	2 (25%)
5	Do you think that financial ratios are useful in evaluating and predicting the performance of a business as well as certifying areas that require improvement?	7 (87.5%)	1 (12.5%)
6	Do you agree with the saying that rotor analysis helps it's to ask the right questions but do not provide answers unless the right comparative standards and techniques are used?	5 (62.5%)	3 (37.5%)
7	Are there obstacles to the proper use of ratio analysis in your business?	7 (87.5%)	1 (12.5%)
8	Does financial retro helps to unravel the mass of truth hidden in financial statement?	7 (87.5%)	1 (12.5%)

Figure 2: Number of Responses of Non-management Staff



As shown in the above table regarding the responses of management staff, it is found that-

1. Do you believe that financial statements- income statement and balance sheet are effective ways of communicating financial information?
   - 100% of respondents agreed that the financial statements- income statement and balance sheet are effective ways of communicating financial information.
2. Is ratio analysis used by your firm as a decision making tool?
   - 100% of respondents agreed that the ratio analysis used by your firm as a decision making tool.
3. Do you agree that ratio analysis facilitates proper understanding of information contained in financial statements?
   - 87.5% of respondents agreed that the ratio analysis facilitates proper understanding of information contained in financial statements while 12.5% not agreed.
4. Do you think that ratio analysis is useful to management, investing shareholders and creditors in their business decisions?
   - 75% of respondents agreed that the ratio analysis is useful to management, investing shareholders and creditors in their business decisions and 25% not agreed.
5. Do you think that financial ratios are useful in evaluating and predicting the performance of a business as well as certifying areas that require improvement?
   - 87.5% of respondents agreed that the financial ratios are useful in evaluating and predicting the performance of a business as well as certifying areas that require improvement while 12.5% of the respondents disagreed.
6. Do you agree with the saying that ratio analysis helps its to ask the right questions but do not provide answers unless the right comparative standards and techniques are used?
   - 62.5% of respondents agreed that the ratio analysis helps to ask the right questions but do not provide answers unless the right comparative standards and techniques are used and 37.5% not agreed.

7. Are there obstacles to the proper use of rotor analysis in your business clerisies?

- 87.5% of respondents agreed that the proper use of rotor analysis in your business clerisies and 12.5% not agreed.

8. Does financial ratio helps to unravel the mass of truth hidden in financial statement?
   - 87.5% of respondents agreed that the financial retro helps to unravel the mass of truth hidden in financial statement and 12.5% not agreed.

Conclusion

Financial statement is prepared primarily for decision making. They play a dominant role in setting the framework of managerial decision. But the information provided in the financial statement is not end in itself as no meaningful conclusions can be drawn from this statement alone. However, the information provided in the financial statement is of immense use in making decisions through analysis and interpretation of financial statement.

Ratio analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account. Ratio analysis is one of the powerful tools of the financial analysis. A ratio is the relationship between two accounting items expressed mathematically. Ratio analysis helps the analyst to make quantitative judgment with regard to concerns financial position and performance.

Ratio analysis even helps in making effective control of the business. Standard ratio can be based upon perform financial statement and variances or deviations, if any, can be found by comparing the actual with the standards so as to take a corrective action at the right time. Ratio analysis is of much help in financial forecasting and planning.

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