DRIVING

FINANCIAL PERFORMANCE

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Cleared self-assessment test for Independent Directors Database

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- Role of directors in enhancing financial performance
- Effective practices for driving financial performance
- Tools for monitoring performance
- Shareholder value creation

REVIEWS

- Destruction of a business because of unintended wrong financial and business decisions
- Two perspectives of financial review
  - Time series analysis
  - Cross-section analysis
- Two styles of financial review
  - Horizontal
  - Vertical

FINANCIAL HEALTH

- Loans vis-à-vis Cash / Bank
- Inventory
- Immovable Properties
- Debtors
- Continued Losses – Overall 2 years - CARO
- Related Party Transactions
- Ratio Analysis
- Trend Analysis
- Comparison with Competitors

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INTERPRETATION OF FINANCIAL STATEMENTS

- Major information required for decision making may be instantly available in various disclosures made in annual report
- Make Horizontal, Vertical and Ratio Analysis of financial data's for last 4 years
- Make comparative study of financial data with base year or benchmarks already fixed
- Make cross section analysis of financial data with that of the other companies operating under similar conditions

TIME SERIES ANALYSIS

- Comparison of two P&L a/c's or two balance sheets of different periods of the same company
- Possibilities of distortion:
  - Outliers and irrational combinations of numbers
  - Periods of varying lengths
  - Major changes in the units' structures
  - Major happenings
  - Dissimilar formats and contents
- Time series analysis to be required by directors:
  - When annual accounts are discussed and cleared
  - When operating budgets are approved

CROSS-SECTION ANALYSIS

- Comparison of two separate entities on same platform
- Same industry, same geography or some other similar facet like remuneration packages or age distribution
- Benefits of cross-section review of financials:
  - Tracing differences in the company's ratios to decisions & events
  - Ideas for bench-marking and improvement
- Two major techniques for cross-section analysis and time series analysis
  - Common size statements
  - Ratio analysis
- Single most preferred method: ratio analysis

FINANCIAL ANALYSIS USING RATIOS

- A window to a company's financial statements
- Examples of benefits of ratio analysis
  - To bankers and lenders (example: debt to equity)
  - To management (example: gross margin and expense ratios)
  - To creditors (example: quick ratio – cash compared to current liabilities)
  - To shareholders and investors (example: price to earnings)
- A 6th category of ratios of importance to directors: Compliance Ratios

RATIO ANALYSIS

- Ratio is a statistical yardstick that provides a measure of relationship between two accounting figures. It may be expressed as a co-efficient, proportion & percentages.
- Types of ratios may be:
  - Liquidity Ratios
  - Solvency Ratios
  - Activity / Efficiency Ratios
  - Profitability Ratios
  - Owners Ratios

PROFITABILITY RATIOS

- How far a Company is successful in its activities is largely dependent upon its profitability and comparison of the same with other companies in the segments and industry average.

KEY PROFITABILITY RATIOS

Net Profit	• Net Profit / Sales
Gross Profit	• Gross Profit / Sales
Return on Total Assets	• EBIT / Total Net Assets
Return on Equity	• Net Income / Equity Share Capital

ACTIVITY / EFFICIENCY RATIOS

- Activity Ratios measures the efficiency with which assets are converted into sales.
- Activity ratios are derived by dividing sales by the book value of the assets.
- These ratios are basically productive ratios in relation to fixed assets and liquidity ratios in relation to current assets

KEY ACTIVITY RATIOS

Inventory Turnover	• Cost of Goods Sold/ Avg. Inventory
Debtors Turnover	• Net Sales / Avg. Debtors
Fixed Assets Turnover	• Sales / Fixed Assets
Assets Turnover	• Sales / Total Assets

LIQUIDITY RATIOS

- Liquidity is the ability of a Company to meet its short term obligations like payment of Creditors, BP, Outstanding Exp. etc.
- A Co. may be profitable and yet not liquid.
- A Co. which is not liquid may sooner or later find itself in a situation of insolvency.
- Thus liquidity in a way is more important than profitability.

KEY LIQUIDITY RATIOS

Current / Working Capital	• Current Assets / Current Liabilities [Id - 2:1]
Cash	• Cash + Bank + Mkt Sec / Current Liabilities [Id - 1:1]
Operating Cash Flow	• Op. Cash Flow (Net Income (+/-) change in WC + Non-cash expenses) / Current Liabilities [Id – 1:1]
Acid Test / Quick	• Quick Assets (Cash + Govt. Sec. + Receivables)/ Current Liabilities [Id – 1:1]

SOLVENCY RATIOS

- These ratios concerns regarding the long term risk of the company i.e. Its ability to service long term debts. These ratios measure :
  - Ability to cover current cost of debt from income generated by existing operations
  - Current level of financial leverage

KEY SOLVENCY RATIOS

Interest Coverage	PBDITA / Interest
Debt Coverage	PBDIA / Due Installment + Int. on Long Term Debt
Debt Equity	Total Outside Liability / Tangible Net worth

OWNERS RATIOS

- These ratios are useful to Stakeholders to judge the current status of their investment.
- Based upon the analysis, they may take a decision to hold their investment until an opportune time, buying further shares or dispose off their existing holding.

KEY OWNERS RATIOS

Earning per Share	• Net Income / No. of Eq. Shares
Price Earning	• Market Price / EPS
Market Book	• Market Price / Book Value per share
Dividend Pay out	• Dividend Payout / EPS

LIMITATION OF RATIO ANALYSIS

- It is based on FS which are them selves subject to several limitations.
- In case of inter-firm comparison, no two firms are similar in age, technology adopted, size & product profile.
- Both inter-period & inter-firm comparisons are affected by price level changes. Change in price-level can affect the validity of ratios calculated for different time periods.

TREND ANALYSIS

- FS are compared for a no. of years to find out the trend. Since such FS constitute a time series in statistical sense. It is also known as Time Series Analysis.
- Each item in Co's FS is placed horizontally for no. of years. This facilitates increase / decrease in particular item for two periods or over a period.
- Such comparison may be made with help of absolute figures or by percentages.

VERTICAL ANALYSIS

- Here we consider, FS for a single year.
- It is a method of FS analysis in which each entry for each of the three major categories of accounts, or assets, liabilities & equities, in a B/S is represented as a proportion of the total account
- Such converted statements are also called common size statements

CROSS SECTIONAL ANALYSIS

- It is comparison of performance of a Co. with that of a similar Co. or performance of the industry as a whole.
- Compare ratios of Co. with that of competing co. or industry as a whole.
- Data for cross sectional analysis - CMIE, CII, Stock Exchange etc.
- Cross sectional analysis is difficult in case of diversified company as they do not came under single industry umbrella.

COMPLIANCE RATIOS

Statutory compliance performance and loss arising from non-compliance			
From Profit & Loss Account			
PONC or Price of Non-conformation =	Fines & penalties ÷ PAT	2.5 ÷ 125	0.02
Dispute ratio =	Value of notices, demands etc. ÷ total statutory charges	165 ÷ 110	1.50
From the balance sheet			
Contingent liability ratio =	Contingent liability value ÷ Reported liability value	2,300 ÷ 6,900	0.33
Off-balance sheet financing ratio =	Off-balance sheet finance ÷ Reported value of financing	540 ÷ 5,400	0.10

RATIOS – SCH. III

- Ratios along with numerator & denominator - explanation if variation > 25% - CARO – Cl. (19)

1. Current Ratio
2. Debt-Equity Ratio
3. Debt Service Coverage Ratio
4. Return on Equity Ratio
5. Inventory Turnover ratio
6. Trade Receivables Turnover ratio
7. Trade Payables Turnover ratio
8. Net Capital Turnover ratio
9. Net Profit ratio
10. Return on Capital employed
11. Return on Investment.

ROLE OF DIRECTORS IN DRIVING PERFORMANCE

- Key role: Protect the interests of the Company and the external investors in the short and the long term
- Actions
  - Oversight of strategy and strategic decisions
  - Participation in CEO appointment, succession planning, managerial remuneration
  - Oversight of financial reporting and legal compliance
  - Performance monitoring through review of ratios
- Independent directors to take financial review seriously and ask questions on the Company's financial performance

EFFECTIVE PRACTICES

- Active involvement in Board meetings by preparing well and attending every meeting and asking questions, particularly on financial matters
- Board Agenda to focus on key strategic issues/ value drivers and risks – focus the Board time available on what is critical
- Demanding structured information from the executive management in regard to financial performance and position
- Bringing an external perspective using relevant experience

MEASURING SHAREHOLDER VALUE

$$\text{Shareholder Value} = \frac{\text{Dividends} + (\text{Ending Price} - \text{Beginning Price})}{\text{Beginning Price}}$$

$$= \text{Dividend Yield} + \text{Price Appreciation}$$

Example – Company XYZ Ltd.

Ending stock price (31/3/2024)	**Rs 66.06**
Beginning stock price (1/4/2023)	**Rs 50.86**
Capital gain on XYZ Ltd. stock	**Rs 15.20**
Dividend	**Rs 1.9125**

Shareholder Value = 1.9125/50.86 + 15.20/50.86

= .0376 + .2986

= .3362 or (33.62%)

PERIODICAL COMPLIANCES

- GST Deposits & Returns
- MSMED Act 2006
- Labour Laws dues and deposits
- TDS / TCS deposit and returns
- SFT Returns
- IT Returns
- Company Law / LLP Compliances
- SEBI Compliances
- RBI / FEMA Compliances

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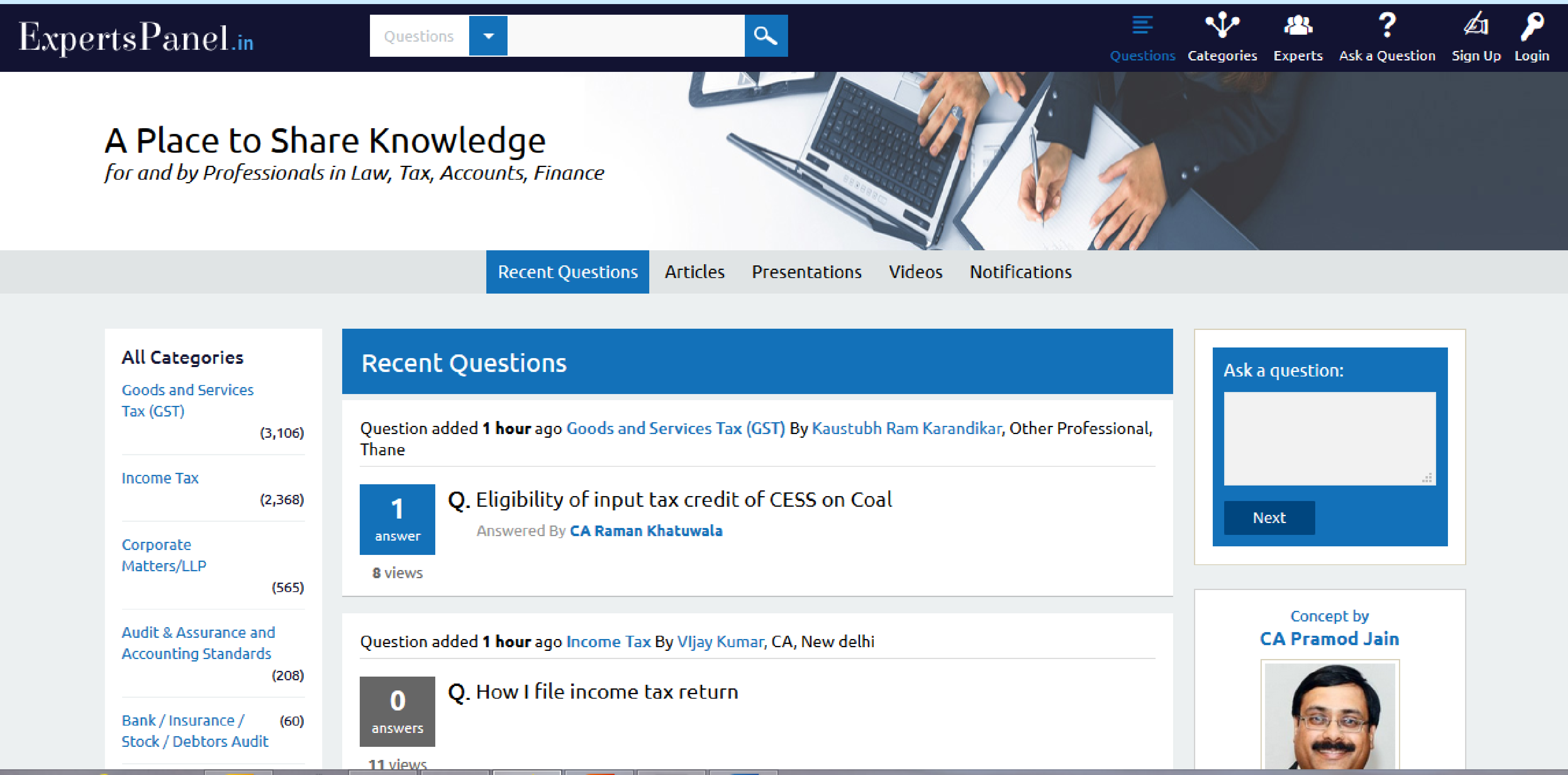

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Thank You!

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