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# FINANCIAL PERFORMANCE USING RATIO ANALYSIS

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**ABSTRACT :** *The greatness of an organization can be identified when its financial performance is strong from time to time. The financial manager often conduct financial analysis, especially financial ratios to analyze the evolution of the firm's financial situation. This study focuses in evaluating the companies' performance by using the ratio analysis methods of the Multi Level Marketing (MLM) Company. The methodology approach, which is based on the secondary data analysis of the financial statements for previous five years (2013 to 2017). The study concluded that the analysis of the financial statements for the MLM company leads to identify and explain the undesired extreme. Four types of financial ratio namely liquidity ratio, activity ratio, leverage ratio and profitability ratio were used. This study found that the financial position of the company is not satisfactory. Researchers also proposed a few strategies to improve the Company's financial ratios.*

**KEYWORDS -** *Financial Performance, Financial Manager, Financial Analysis, Ratio Analysis*

## 1. INTRODUCTION

All organizations are interested in achieving their corresponding goals. An organization's greatness can be recognized from time to time when its economic performance is strong. Any organization's economic performance relates to the act of carrying out its economic activity. It is a method for measuring the general economic health of a company over a specified period and can be used to compare similar firms across the same sector or to compare the aggregated industries or sectors [1]. A financial manager can assist managers and other stakeholders to make decisions about an organization's economic performance. They often perform economic analysis, particularly financial ratios, to evaluate the evolution of the financial situation of the firm (trend analysis), cross-sectional analysis, and comparative analysis. Productivity, profitability, price, liquidity, solvency, capital structure, and capital market are among indicators used to categorize financial ratios. Financial ratios are the most popular and most commonly used methods of financial analysis because they can be used as input data for more complex mathematical models [2].

## 2. THE PROBLEM STATEMENT

Financial report information such as Income Statement and Statement of Financial Position may indicate a company's financial condition. According to the history of the financial statements of MLM Company, it showed a decline stage in profits from 2013 to 2017 (refer Table 1) [18]. The researcher wants to investigate the cause of the phenomenon and provides suggestions to the management of the company to resolve it.

Table 1: MLM Company's profit

| **Income Statement (2013-2017)** | | | | | |
|---|---|---|---|---|---|
| | **2013 (RM'000)** | **2014 (RM'000)** | **2015 (RM'000)** | **2016 (RM'000)** | **2017 (RM'000)** |
| **Profit for the period** | **109,082** | **99,950** | **64,302** | **54,669** | **52,624** |

Source: Annual Report

## 3. OBJECTIVES OF THE STUDY

This study aims to determine MLM Company financial performance by using ratio analysis indicator (liquidity ratio, profitability ratio, activity ratio and leverage ratio).

## 4. CONCEPTUAL FRAMEWORK

All analysis ratios (liquidity, profitability, activity and leverage) are independent variables while financial performance is dependent variable.

LIQUIDITY RATIO
PROFITABILITY RATIO
ACTIVITY RATIO
LEVERAGE RATIO

→ FINANCIAL PERFORMANCE

### 4.1 Significance of the Study

This study is important for the management team of the firm. After the ratios are calculated, the management can be compared to the industry standards, the company's past results, projections, and goals. It's also to highlight trends and identify strengths and weaknesses. Ratio analysis is very useful for the investor because they can assess the liquidity, profitability, financial strength, and efficiency of an organization. These information can help them greatly in making good investment decisions.

## 5.0 LITERATURE REVIEW

### 5.1 Financial Ratio

Financial ratios are a significant tool for analyzing financial statements. A ratio is a mathematical number calculated as a reference to a two-or more-number relationship and can be expressed as a fraction, proportion, percentage, and number of times. When the number is calculated by referring to two financial statements accounting numbers, it is called the financial ratio[3]. Ratios can be widely categorized into four classifications for the purpose of analysis such as liquidity ratios, profitability ratios, activity ratios and leverage ratios.

### 5.1.1 Liquidity Ratio

Basically, the liquidity ratio is a method that an organisation uses to transform its existing assets into money. Whenever the organisation needs to fulfil its economic commitments, it transforms its existing assets into money to pay the due liabilities at maturity date [4]. The greater the liquidity ratios, the greater the Company's margin of safety to meet its current liabilities. If liquidity ratios are higher than one, it shows that the company is in good (favourable) financial health and that it is not supposed to fall into economic issues as much as possible[5]. If the liquidity ratios of the Company do not match the usually accepted standards, such scenario requires efficient techniques for liquidity improvement. The Company's financial manager can improve its liquidity ratios by controlling its current assets and short-term liabilities. It can be executed in several ways such as accounts receivables monitoring, managing accounts payable, payment of current liabilities, increasing current assets with equity or selling unproductive assets [6].

### 5.2.3 Activity Ratio

Business asset management uses activity ratios because they assess how efficiently an organization subject manages its assets. The organization subject rates the commitment of individual items of the capital in certain forms of assets. If the organization subject does have more assets than is appropriate, unnecessary costs will be incurred and the profit will be adjusted (favourable). In contrast, if the organisation subject has few assets, the potential income may be lost (unfavorable) [7]. We suggest continuous inventory surveillance at the moment of stock turnover to avoid 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 [8].

### 5.2.4 Leverage Ratio

Also known as a gearing ratio or equity multiplier is a leverage ratio. Leverage ratio demonstrates how efficiently the organisation utilizes cash from other people and whether it is using a lot of borrowed money [9]. Generally, companies with higher leverage as determined by a leverage ratio are thought to be more risky (unfavourable) because they have more liabilities and less equity. A high debt ratio is viewed as risky by investors, especially lenders [10].

The high leverage ratio can be resolved if the Company reduces its dependence on others in financing its needs, which means a reduction in the risk faced by the Company if it has not fulfilled its commitment to others [11] or if the Company attempts to decrease the amount of short-term liabilities [8].

5.2.5 Profitability Ratio

Profitability ratios are indicators of the general effectiveness of the organization. Profitability ratios measures the organization's earning capacity and is seen as an indicator of its development, achievement, and control. Profitability ratios concentrate on the return on investment in stock and other assets of a company. These ratios basically show how well companies can achieve profits from their operations [12]. According to a research done by [13], the profitability ratio has an significant beneficial effect on the evaluation of firm performance. This means that the increase in the profitability ratio will result in a substantial rise (favourable) rise in firm performance evaluation.

While, net profit of the organization is going down, thus it is not good (unfavourable) for the Company by [14].

The company can enhance its profitability ratio in various ways, the most important is its pricing strategy and operational efficiency. These methods show the residual revenue after paying multiple variable costs such as salaries, raw materials, etc. [15].

5.3 Financial Performance

The performance is a general term applied to the person in charge of an organization's activities over a period of time to evaluate past or projected cost efficiency, responsibility of management or accountability or the like. Thus, not only the presentation, but the quality of results achieved reflects to the performance. Performance is used to show the favourable or unfavourable conditions of the organization.

Financial performance refers to the degree to which financial goals are or have been achieved. It is the process of monetary measurement of the results of the policies and operations of a company. It is used to evaluate the general economic health of the company over a specified time period and can also be used to compare comparable firms across the same sector or to compare industries or sectors in aggregation by [16].

## 6.0 METHODOLOGY

This study uses the secondary data obtained by [19] that is the MLM Company financial statements on the period of 2013-2017 [18]. Table 2 showed the Income Statements of the company and Table 3 showed the Financial Position of the company.The study calculates the liquidity ratios, profitability ratios, activity ratios and leverage ratios. Then, from the calculation of these ratios, financial performance of MLM Company can be determined as a result of this study. That financial performance is used to indicate organization’s favourable or unfavourable conditions.

Table 2: Income statement

| **Income Statement (2013-2017)** | | | | | |
|---|---|---|---|---|---|
| | **2013** | **2014** | **2015** | **2016** | **2017** |
| Revenue | 834 222 | 855 804 | 1 019 924 | 1 087 501 | 984 214 |
| Cost of sales | (568 185) | (597 341) | (763 522) | (815 522) | (740 024) |
| **Gross profit** | **266 037** | **258 463** | **256 402** | **271 979** | **244 190** |
| Other income | 5 530 | 7 007 | 8 235 | 9 229 | 6 147 |
| Selling and administrative expenses | (83 961) | (90 655) | (129 988) | (159 076) | (131 797) |
| Distribution expenses | (42 140) | (40 201) | (45 331) | (49 124) | (48 039) |
| **Profit before tax** | **145 196** | **134 614** | **89 318** | **73 008** | **70 501** |
| Income tax expenses | (36 173) | (34 766) | (25 390) | (18 359) | (17 857) |
| **Profit net of tax** | **109 023** | **99 848** | **63 928** | **54 649** | **52 644** |
| Foreign currency translation | 59 | 102 | 374 | 20 | -20 |
| Other comprehensive income of the year, net of tax | 59 | 102 | 374 | 20 | -20 |
| Total comprehensive income for the year | 109 082 | 99 950 | 64 302 | 54 669 | 52 624 |
| Profit attributable to owners of the parent | 109 023 | 99 848 | 63 928 | 54 649 | 52 644 |
| Total comprehensive income attributable to owner of the parent | 109 082 | 99 950 | 64 302 | 54 669 | 52 624 |
| Earnings per share attributable to owners of the parent (sen per share) | | | | | |
| Basis | 66.32 | 60.74 | 38.89 | 33.24 | 32.02 |

Source: Annual Reports.

Table 3: Financial Position

| Financial Position(2013-2017) | | | | | |
|---|---|---|---|---|---|
| **Assets:** | **2013** | **2014** | **2015** | **2016** | **2017** |
| Property, plant and equipment | 71 583 | 66 704 | 64 258 | 64 218 | 60 718 |
| Intangible assets | 4 782 | 4 782 | 4 782 | 4 782 | 4 782 |
| Investment in subsidiaries | | | | | |
| Deferred tax assets | 4 832 | 4 938 | 13 210 | 17 653 | 8 545 |
| **Total non-current assets** | **81 197** | **76 424** | **82 250** | **86 653** | **74 045** |
| Inventories | 64 651 | 84 429 | 83 903 | 94 894 | 126 159 |
| Trade and other receivables | 30 209 | 28 434 | 46 017 | 40 787 | 46 099 |
| Cash and cash equivalent | 152 883 | 173 272 | 182 473 | 200 551 | 163 402 |
| **Total current assets** | **247 743** | **286 135** | **312 393** | **336 232** | **335 660** |
| **Total assets** | **328 940** | **362 559** | **394 643** | **422 885** | **409 705** |
| | | | | | |
| **Equity:** | | | | | |
| Share capital | 164 386 | 164 386 | 164 386 | 164 386 | 166 436 |
| Share premium | 685 | 685 | 685 | 685 | |
| Capital redemption | 1 506 | 1 608 | 1 982 | 1 365 | |
| Forex translation reserve | | | | 637 | 617 |
| Retained earnings | 67 734 | 64 841 | 38 357 | 43 691 | 47 020 |
| **Total equity attributable to owners of the parent** | **234 311** | **231 520** | **205 410** | **210 764** | **214 073** |
| **Liabilities:** | | | | | |
| Deferred tax liabilities | 30 | 25 | 27 | 11 | 21 |
| **Total non-current liabilities** | **30** | **25** | **27** | **11** | **21** |
| Trade and other payables | 86 470 | 124 378 | 180 529 | 204 686 | 195 261 |
| Current tax payable | 8 129 | 6 636 | 8 677 | 7 424 | 350 |
| Total current liabilities | 94 599 | 131 014 | 189 206 | 212 110 | 195 611 |
| Total liabilities | 94 629 | 131 039 | 189 233 | 212 121 | 195 632 |
| **Total equity and liabilities** | **328 940** | **362 559** | **394 643** | **422 885** | **409 705** |

Source: Annual Reports.

## 7.0 RESULT AND DISCUSSION

7.1 The Analysis of Liquidity Ratios

Table 4 shows the comparison of liquidity current year's ratio with the previous year. Current ratio and quick ratio mostly unfavourable (UF). This result showed that the current ratio of MLM Company is in decreasing trend. This shows that the Company is facing difficulty in settling short-term debt. Overall performance of liquidity ratios show that company position is bad. It was different to previous research done by [14].

Table 4: Liquidity ratio analysis

| Liquidity ratio | 2013 | 2014 | C | 2015 | C | 2016 | C | 2017 | C |
|---|---|---|---|---|---|---|---|---|---|
| Current ratio = Current asset/Current liability | 2.62x | 2.18x | UF | 1.65x | UF | 1.59x | UF | 1.72x | F |
| Quick ratio = (Current asset – inventory)/Current liability | 1.94x | 1.54x | UF | 1.21x | UF | 1.14x | UF | 1.07x | UF |

Note: C = comment; F = Favourable; UF = Unfavourable; x = Times

7.2 The Analysis of Profitability Ratios

Table 5 above showed the return of the company. All profitability ratios mostly unfavourable (UF). This result showed that the profitability ratios of MLM Company are in fluctuating trend. Overall performance of profitability ratio shows the poor financial position of the firm. It was similar to previous research done by [17].

Table 5: Profitability ratio analysis

| Profitability ratio | 2013 | 2014 | C | 2015 | C | 2016 | C | 2017 | C |
|---|---|---|---|---|---|---|---|---|---|
| Gross profit Margin = (Gross profit/ Sales) x 100 | =31.89 % | =30.2% | UF | =25.14% | UF | =25.01% | UF | =24.81% | UF |
| Net profit margin = (Net profit/sales) x 100 | =13.08 % | =11.68 % | UF | =6.3% | UF | =5.03% | UF | =5.35% | F |
| Return on Assets = (Net income/total assets) x 100 | =33.16 % | =27.57 % | UF | =16.29% | UF | =12.93% | UF | =12.84% | UF |
| Return on equity = (Net income/owner equity) x 100 | =46.55 % | =43.17 % | UF | =31.30% | UF | =25.94% | UF | =24.58% | UF |

Note: C = comment; F = Favourable; UF = Unfavourable

7.3 The Analysis of Activity Ratios

The efficiency of company activities is shown in Table 6. All activity ratios showed unfavourable (UF). This result showed that the activity ratios of MLM Company are in decreasing trend. Actually the company was not efficient in conducting sales activity. The overall performance of the activity ratios decreased every year, which was not satisfactory. It was similar to previous research done by [1].

Table 6: Activity ratio analysis

| Activity ratio | 2013 | 2014 | C | 2015 | C | 2016 | C | 2017 | C |
|---|---|---|---|---|---|---|---|---|---|
| Account receivable turnover= Credit sales/ Account receivable | 27.6x | 30.09x | F | 22.16x | UF | 19.99x | UF | 16.05x | UF |
| Average collection period= (Account receivable/Sales) x 360 days | 13 days | 12 days | F | 16 days | UF | 18 days | UF | 22 days | UF |
| Inventory turnover= Cost of goods sold/Inventory | 12.90x | 7.08x | UF | 0.75x | UF | 8.59x | F | 5.87x | UF |
| Fixed assets turnover= Sales/Fixed asset | 10.27x | 7.82x | UF | 12.40x | F | 9.41x | UF | 9.994x | UF |
| Total assets turnover= Sales/Total asset | 2.54x | 1.65x | UF | 2.58x | F | 1.93x | UF | 1.81x | UF |

Note: C = comment; F = Favourable; UF = Unfavourable; x = Times

7.4 The Analysis of Leverage Ratio

The company condition on liability was shown in Table 7. From year 2013 to 2017, debt and debt to equity ratio were shown unfavourable (UF). The leverage ratios for the last five years were in increasing trend. It means that the company was considered to be more risky to lenders, creditors and investors. This finding is similar to the previous research done by [16].

Table 7: Levarage ratio analysis

| Leverage ratio | 2013 | 2014 | C | 2015 | C | 2016 | C | 2017 | C |
|---|---|---|---|---|---|---|---|---|---|
| Debt ratio = (Total liability/Total asset) x 100 | 28.77% | 36.14% | **UF** | 48.0% | **UF** | 30.16% | **F** | 47.75% | **UF** |
| Debt on equity = (Total liability/Owner equity) x 100 | 40.39% | 56.6% | **UF** | 92.12% | **UF** | 100.64% | **UF** | 91.39% | **F** |

Note: C = comment; F = Favourable; UF = Unfavourable

## 5.0 CONCLUSION AND SUGGESTION

This study found that the financial position of the company is not satisfactory. Hence, researchers have proposed a few strategies to improve the company's financial ratios.

In order to solve liquidity ratio problem, if the company has unproductive assets that the business is just storing, then it is time to get rid of them. The only reason company should spend money on assets such as buildings, equipment and vehicles is to generate revenue. Other strategy is the management must improve the current ratio by lowering the current liabilities.

Profitability ratios problem could be solved if the company could review the sales price of product to increase revenues. Other alternative to increase the gross profit margin, the cost of goods sold must be lowered by purchasing good quality materials at less price, worker’s efficiency can be improved and scraps can be decreased.

Activity ratios issues could be minimized if the management implements better payment policy to satisfy the customers and also improve their inventory cost. The management could reduce setup and change over costs from manufacturers. Oftentimes, businesses that employ manufacturing services for a long period of time can negotiate for better pricing.

Leverage ratios can be solved by implementing a debt or equity swap, a company can make a debt holder an equity shareholder in the Company. This will cancel the debt owed to him and in turn, reduce the debt of the company and improve the ratio. Another strategy is the company takes on debt to purchase specific assets. This is referred to as “asset-backed lending” and is very common in real estate and purchases of fixed assets like property, plant, and equipment.

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