Chapter III: RATES AND RATIOS

The basic data, if presented in the form of combined balance sheet and profit and loss account, may not by themselves bring out, at a glance, various financial aspects and trends in the corporate sector or enable comparisons at different points of time. Therefore, a few important financial ratios derived from the basic data have been presented in the compendium. Such ratios will shed light on aspects such as the capability of the companies to meet their short-term liabilities under normal circumstances, the adequacy or otherwise of the working capital, trends in profitability, whether there is dependence on short-term funds for long-term investments, or whether an unduly large amount of capital is tied up in inventory build-up. These ratios will also facilitate comparisons in performance over a period of time.

Annual growth rates in terms of percentage increase have been presented in this volume for a few important items considered as indicators of the corporate financial performance. These growth rates are adjusted for changes due to amalgamation of companies. The increase in value of assets in some cases is due to revaluation. While working out the growth rates, the extent of increase/decrease due to revaluation has been adjusted from 1966-67 onwards.

III.1 The growth rates presented in this volume broadly pertain to the following items:

(i) Sales
(ii) Value of production
(iii) Total Income
(iv) Manufacturing expenses
(v) Remuneration to employees
(vi) Depreciation provision
(vii) Gross profits
(viii) Interest
(ix) Operating profits
(x) Non-operating surplus/ deficit
(xi) Profits before tax
(xii) Tax provision
(xiii) Profits after tax
(xiv) Dividends
(xv) Profits retained
(xvi) Gross saving
(xvii) Gross value added
(xviii) Net value added
(xix) Net worth
(xx) Total borrowings
(xxi) Bank borrowings
(xxii) Trade dues and other current liabilities
(xxiii) Gross fixed assets
(xxiv) Net fixed assets
(xxv) Inventories
(xxvi) Gross physical assets
(xxvii) Net physical assets
(xxviii) Total gross assets
(xxix) Total net assets

(xxx) Total earnings in foreign currencies and
(xxxi) Total expenditure in foreign currencies

The definitions of these terms have been explained in the last Chapter on ‘Concepts and definitions of specified heads of accounts’. The explanations for some of the selected terms are as follows:

‘Total income’ comprises (a) value of production, (b) other income and (c) non-operating surplus/deficit.

‘Manufacturing expenses’ comprises (a) raw materials, components, etc., consumed, (b) stores and spares consumed, (c) power and fuel and (d) other manufacturing expenses.

‘Remuneration to employees’ comprises (a) salaries, wages and bonus, (b) provident fund and (c) employees’ welfare expenses.

‘Gross saving’ is measured as sum of retained profits and depreciation provision.

‘Gross value added’ comprises (a) net value added and (b) depreciation provision.

‘Net value added’ comprises (a) salaries, wages and bonus, (b) provident fund, (c) employees’ welfare expenses, (d) managerial remuneration, (e) rent paid net of rent received, (f) interest paid net of interest received, (g) tax provision, (h) dividends paid net of dividends received and (i) retained profits net of non-operating surplus / deficit.

‘Equity’ or ‘Net worth’ comprises (a) paid-up capital, (b) forfeited shares and (c) all reserves and surplus.

‘Gross physical assets’ comprises (a) gross fixed assets and (b) inventories.

‘Net physical assets’ comprises (a) net fixed assets and (b) inventories.

‘Total net assets’ is derived by subtracting minimum of tax provision and advance of income tax from the total assets.

‘Total gross assets’ is the sum of total net assets and depreciation.

III.2 Selected financial ratios (expressed in percentage):

The financial ratios compiled and disseminated in the compendium are broadly grouped into the following categories viz., Capital structure ratios, Liquidity ratios, Assets utilisation and turnover ratios, Sources and uses of funds ratios and Profitability and profit allocation ratios.

III.2.1 Capital structure ratios

(i) Net fixed assets to total net assets
(ii) Net worth to total net assets
(iii) Debt to equity
(iv) Debt to equity (adjusted for revaluation)
(v) Short term bank borrowings to inventories

(vi) Total outside liabilities to net worth

Net fixed assets to total net assets measures the share of net fixed assets in total capital employed in the business. Net worth to total net assets gives an idea of the proportion of assets financed by shareholders. Debt to equity indicates the relation between the borrowed funds of long-term nature and owned funds. Short-term bank borrowings to inventories indicates the extent to which companies rely on banks for financing their working capital requirements which comprise, inter-alia, inventory holdings, payments of wages and salaries and other current manufacturing expenses. Total outside liabilities to net worth throws light on the relative interests of creditors and shareholders.

III.2.2 Liquidity ratios

(i) Current assets to current liabilities
(ii) Quick assets to current liabilities
(iii) Current assets to total net assets
(iv) Sundry creditors to current assets
(v) Sundry creditors to net working capital

'Current assets' comprise (a) inventories, (b) loans and advances and other debtor balances, (c) book value of quoted investments, (d) cash and bank balances and (e) advance of income-tax in excess of tax provision.

'Current liabilities' comprise (a) short-term borrowings from banks, (b) unsecured loans and other short-term borrowings from companies and others, (c) trade dues and other current liabilities and (d) tax provision in excess of advance of income-tax and other current provisions.

'Quick assets' comprise (a) sundry debtors, (b) book value of quoted investments and (c) cash and bank balances.

Current assets to current liabilities also termed as the current ratio (presented as actual ratio) broadly indicate the extent to which current liabilities are covered by current assets. The ratio of quick assets to current liabilities, referred to as quick ratio measures the liquidity of the company taking only those assets which can be readily converted into cash for meeting the current obligations. Sundry creditors to current assets and Sundry creditors to net working capital measure the extent to which liquid resources are available to meet the liabilities payable by the company. Net working capital is defined as the current assets in excess of current liabilities.

III.2.3 Assets utilisation and turnover ratios

(i) Sales to total net assets
(ii) Sales to gross fixed assets
(iii) Inventories to sales
(iv) Sundry debtors to sales
(v) Exports to sales
(vi) Gross value added to gross fixed assets
(vii) Raw materials consumed to value of production

The capital efficiency ratios aim at measuring the efficiency with which assets are deployed in business in terms of sales arising there from. While interpreting these ratios, it should however, be borne in mind that sales might depend on several other factors also such as credit sales policy, efficiency of the sales/marketing organisation etc. Exports to sales explain the share of merchandise exports in sales. Gross value added to gross fixed assets ratio is a measure of income generated per unit of gross fixed capital.

III.2.4 Sources and uses of funds ratios

(i) Gross fixed asset formation to total uses of funds
(ii) Gross capital formation to total uses of funds
(iii) External sources of funds to total sources of funds
(iv) Increase in bank borrowings to total external sources
(v) Gross saving to gross capital formation

The ratio of gross fixed asset formation/gross capital formation to total uses of funds indicate the share of funds deployed into gross fixed assets and/or inventories. The ratio of external sources of funds to total sources of funds is a measure of the dependence on the external sources of finance. Gross saving to gross capital formation ratio measures how much of capital formation is financed by own saving. However, these ratios are not available prior to 2000-01 study years.

III.2.5 Profitability and profit allocation ratios

(i) Gross profits to total net assets
(ii) Gross profits to sales
(iii) Profits after tax to net worth
(iv) Tax provision to profits before tax
(v) Profits retained to profits after tax
(vi) Dividends to net worth
(vii) Ordinary dividends to ordinary paid-up capital

The ratios of profits to assets/ net worth indicate the rate of return on investment while the ratio of gross profits to sales (margin on sales) reflects the efficiency of business operation. Profits after tax to net worth, measures total returns on the shareholders' equity.

The profit appropriation ratios reflect the manner in which companies appropriate their profits. The ratio of tax provision to profits before tax indicates the effective tax rate payable by the companies. The residual after providing for tax provision and dividends from profits before tax represents retained profits. The ratio of profits retained to profits after tax, also referred to as the 'profit retention ratio' is a measure of profits ploughed back by companies to augment their reserves.
