

FINANCIAL ACCOUNTING RATIOS AS TOOLS FOR THE EVALUATION OF MANAGEMENT PERFORMANCE: STUDY OF LISTED DEPOSIT MONEY BANKS NIGERIA.

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ABSTRACT

The paper examined the importance of ratio analysis to corporate entities especially deposit money banks by showing its contributions in the evaluation of management performance. The effectiveness of ratio analysis was also examined. A content review method was employed in the study and a critical analysis and summary of existing research on the topic was carried out. From the reviewed carried out, it was concluded that ratio analysis as a valuable tool for making comparisons. It proves beneficial for strategic planning by examining historical ratio estimates. The research also indicates that a diverse range of individuals, including investors, management, shareholders, creditors, employees, firm owners, society, and researchers, can benefit from ratio information. Finally, ratio analysis emerges as an essential instrument for evaluating corporate performance, and it is recommended for consideration by anyone using accounting information to make informed decisions.

Keywords: Accounting Ratio, Performance Evaluation, Liquidity Ratio, Profitability Ratio, Efficiency Ratios, Solvency Ratios, Market Ratios, Growth Ratios, Coverage Ratios, Operating Ratios

INTRODUCTION

Deposit Money banks are essential to the general welfare of the economy. As a result, the Banking sector in Nigeria has undergone remarkable changes since 2005 bank consolidation which led to Central Bank of Nigeria (CBN) taking strong measures to strengthen the performance and reporting standards of the Nigerian Banks. However, despite the appropriate presentation of the various financial statements by banks with their appealing and attractive information in form of monetary value, many of the banks still wind up after a short time period. Many are always at the verge or brink of collapse before being resuscitated (Ayodele, 2015). The problem of such banks might not be unconnected with the inability of the stakeholders to evaluate and assess the viability of the organizations. This has led many investors to groan in pains as a result of investing their funds in banks that are not viable and also putting some would –be investors in dilemma about whether to invest or not. To avert the problem mentioned, there is the need for accounting information users to assess the organizations' performances in terms of their values to them. For the users to appreciate significant changes and relationships in the accounting information, the monetary values reported in the financial statements are frequently converted into percentages or ratios by the statements users which enable them to make decisions that require an assessment or analytical study of the present operations, future prospect and probable outcome of decisions which could be made.

Dursun, Cemil, and Ali (2013) state that ratio analysis can help stakeholders analyse the financial health of a company and using these industries, or within a firm itself. Such a tool can also be used to compare the relative performance of different size companies. Analysing financial accounting ratios can indeed serve as valuable tools for evaluating the performance of management in listed deposit money banks. Ratios provide insights into various aspects of a company's financial health and operational efficiency.

Financial ratio is said to be the relationship between two accounting figures expressed mathematically (Wood and Sangster 2002). It reflects a quantitative relationship which in turn helps to form a qualitative judgment by the management of the firm or by parties outside the firm (Akinsulire, 2006). Wood and Sangster (2002), opined that without ratios, financial statements

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would be largely uninformative to all. But with ratios, financial statements can be interpreted and usefully applied to satisfy the needs of the reader.

Financial ratio analysis is a good choice for uncomplicated and immediate analysis of the financial position of the banks with considerable prediction power (Pandey, 2005). With the help of financial ratio analysis future performance of the bank can be predicted by studying the past trend of return. This allows the investors and shareholders to invest by fact and figures rather than on different assumptions. therefore, a content review is carried on the relevance of financial ratios as tools for the evaluation of management performance.

The Beam: Journal of Arts & Science, Vol. 10, (2017) ISSN: 1118-5953

Umaru Ali Shinkafi Polytechnic Sokoto, Nigeria financial ratios, comparisons can be made across companies within an industry, between

Statement of the Problem

Financial ratios analysis is the most powerful tool used in analysing (financial and operating performances of firms. This technique suffers from some bottle necks which are also inherent in financial statement prepared and presented to the public. Among these setbacks are the fact and figures are mostly computed from historical accounts that is the financial ratio analysis drawn from historical information is of little use in assessing the future prospects of a firm.

Also, there is considerable subjectivity involved as there is no theory as to what should be the right number for the various ratios; ratios may not be accurately comparable across different companies due to a variety of factors such as different accounting practices and different financial year.

Literature Review

Financial accounting ratios

Financial accounting ratios are critical tools used by investors, analysts, and stakeholders to assess the financial health and performance of a company, including the effectiveness of its management. These ratios provide quantitative insights into various aspects of a company's operations, profitability, liquidity, and financial structure. When applied to the context of management performance evaluation, financial ratios offer a systematic way to measure and analyse key aspects of a company's financial management.

According to Pandey (2004), ratio is defined as the indicated quotient of two mathematical expressions and as the relationship between account figures expressed in mathematical form. Solomon (2004), defines ratio as the percentage or decimal that shows the relationship of one number to another.

Financial ratios are quantitative metrics used to assess various aspects of a company's financial performance and position. These ratios provide insights into the company's operational efficiency, profitability, liquidity, solvency, and overall financial health. These ratios serve as valuable tools for analysts, investors, and management to make informed decisions, compare performance against industry benchmarks, and assess the financial health and stability of a company. Here are some key financial ratios commonly used in financial analysis:

Liquidity Ratios:

- Current Ratio: $\text{Current Assets} / \text{Current Liabilities}$
- Quick Ratio (Acid-Test Ratio): $(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$

Profitability Ratios:

- Net Profit Margin: $(\text{Net Profit} / \text{Revenue}) \times 100$
- Return on Assets (ROA): $\text{Net Income} / \text{Average Total Assets}$
- Return on Equity (ROE): $\text{Net Income} / \text{Average Shareholders' Equity}$

Efficiency Ratios:

- Inventory Turnover: $\text{Cost of Goods Sold} / \text{Average Inventory}$
- Days Sales Outstanding (DSO): $(\text{Accounts Receivable} / \text{Total Credit Sales}) \times \text{Number of Days}$

Solvency Ratios:

- Debt-to-Equity Ratio: Total Debt / Shareholders' Equity
- Interest Coverage Ratio: Earnings Before Interest and Taxes (EBIT) / Interest Expense

Market Ratios:

- Price-to-Earnings Ratio (P/E): Market Price per Share / Earnings per Share (EPS)
- Dividend Yield: Dividend per Share / Market Price per Share

Growth Ratios:

- Earnings Growth Rate: (Current Year's Earnings - Last Year's Earnings) / Last Year's Earnings

Coverage Ratios:

- Fixed Charge Coverage Ratio: (EBIT + Lease Payments) / (Interest + Lease Payments)

Operating Ratios:

- Operating Margin: Operating Income / Revenue
- Operating Cash Flow Ratio: Operating Cash Flow / Current Liabilities

Performance Evaluation

Performance evaluation of a company is usually related to how well a company can use its assets, share holder equity and liability, revenue and expenses. Financial ratio analysis is one of the best tools of performance evaluation of any company. In order to determine the financial position of the company and to make a judgment of how well a company is efficient in its operation and management and how well the company has been able to utilize its assets and earn profit different methods and/or tools are used, among which is the financial ratios. Financial ratio can be seen as a relationship between a two individual quantitative financial information connected with each other in some logical manner, and this connection, is considered as a meaningful financial indicator which can be used by the different financial information users.

Brigham and Ehrhardt (2010) state that financial ratios are designed to help evaluate financial statements. Financial ratios are used as a planning and control tool. Financial ratios are used by internal and external financial data users in making their economic decisions; including investing, and performance evaluation decisions. Financial ratios analysis is used to evaluate the performance of an organization in order to determine the strong and weak points and it offers solutions by providing appropriate plans. However, a large number of standards and various financial ratios exist but the choice of ratios used depends on the activity of the organization and the purpose of analysis (Tofeeq, 1997)

METHODOLOGY

A literature review method was employed. A critical analysis and summary of existing research on the topic was carried out. This involves systematically searching, evaluating, and synthesizing relevant literature to provide an overview of the current state of knowledge on the topic.

FINDING AND CONCLUSION

The review conducted thus far has demonstrated the effectiveness of ratio analysis as a valuable tool for making comparisons. It proves beneficial for strategic planning by examining historical ratio estimates. The research also indicates that a diverse range of individuals, including investors, management, shareholders, creditors, employees, firm owners, society, and researchers, can benefit from ratio information.

Calculated ratios, along with their percentage increments, highlight the potential for improvement in addressing past inefficiencies through the application of ratios. This, in turn, serves as a motivational factor for management and firm owners to enhance their performance. Consequently, ratio analysis emerges as an essential instrument for evaluating corporate performance, and it is

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recommended for consideration by anyone using accounting information to make informed decisions.

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