EFFECTIVENESS OF FINANCIAL RATIOS ANALYSIS IN EVALUATION OF CUSTOMER CREDIT WORTHINESS IN THE BANKING INDUSTRY

(A CASE STUDY OF FIRST BANK PLC)

BY

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BEING A PROJECT SUBMITTED TO THE DEPARTMENT OF BANKING AND FINANCE, INSTITUTE OF FINANCE AND MANAGEMENT STUDIES, KWARA STATE POLYTECHNIC, ILORIN

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CERTIFICATION

This is to certify that this project work has been read and approved as meeting part of the requirement for the award of Higher National Diploma (HND) in Banking and Finance Department, Institute of Finance and Management Studies, Kwara State Polytechnic, Ilorin

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DEDICATION

This project is dedicated to God Almighty, the king of Kings, Lord of Lords, the beginning and the end, the Alpha and Omega, for His love, mercy and kindness over my lives and also to my parents and lecturers.

Also dedicated to my amiable supervisor in person of **Dr. Olowoniyi A.O** and the entire lecturers in banking and finance department.

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ABSTRACT

Financial analysis is the process of identifying the financial strengths and weaknesses of a firm by properly establishing relationships between the assets and liabilities and the performance of that particular firm. First bank in Nigeria need to undertake periodic financial analysis; this could not be unconnected with the recent failures that engulfed the banking industry in Nigeria and its devastating effects on both the customers and shareholders.

The study seeks to evaluate the effectiveness of financial ratios analysis in evaluation of customer credit worthiness in the banking industry. This is to guard against the possible loss suffered by numerous customers, owners and other stakeholders who have interest in such financial institutions. An in-depth analysis of financial statements of a firm tends to provide a deep insight into the operations of that firm. This brings to the fore the genesis and the magnitude of problems that subsequently result in poor performances. Therefore the use of financial ratios in the analysis of performance is an indispensable aid to appraising true performance of firms. This will greatly help management to spot out financial weaknesses of firms and to take suitable corrective actions. Thus, financial analysis is the starting point for making plans before using any sophisticated forecasting and planning procedures. This is necessary as understanding the past is a prerequisite for anticipating the future.

In the course of this study, stratified random sampling was employed to achieve the aims of this research work.

From the data obtained and the analysis made using various financial tools, the financial condition of the banks under study was not very good, according to Altman's model and Osaze's index respectively. Based on the analysis made using the various tools of financial analysis, it is recommended that the banks should majorly cut down their cost of operations and reduce their total debt. This will reduce their operating expenses as well as interest charges paid annually to creditors.

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CHAPTER ONE
INTRODUCTION

1.1 General Background of the Study

Almost all kind of business activities, directly or indirectly, involve the acquisition and use of funds. There are several business activities of an enterprise, among these are; production finance, marketing, etc. out of these activities finance plays an important role. For example, recruitment and promotion of employees in production is clearly a responsibility of the production department; but it requires payment of wages and salaries and other benefits, and thus, involves finance. Similarly, buying a new machine or replacing an old machine for the purpose of increasing productive capacity affects the flow of funds. Sales promotion policies come within the purview of marketing, but advertising and other sales promotion activities require outlays of cash and therefore, affect financial resources. (Pandey, 2000: 5).

Financial management endeavours to make optimal investment, financing and dividend/share repurchase decisions. In an endeavour to make optimal decisions, the financial manager makes use of certain analytical tools in the analysis, planning, and control activities of the firm. Financial analysis is a necessary condition, or prerequisite, for making sound financial decisions. One of the important roles of a chief financial officer is to provide accurate information on financial performance, and the tools taken up will be instrumental in this regard (Van Horne, 2002: 8). However, financial scholars generally explain what financial management is by describing the business organisation as a 'pool of funds' i.e. it is a collection of funds from a variety of sources. The sources include money from investors who invest in the business stock or creditors who lend their money to the business to profit or retained earnings. The funds from these sources are being committed to a number of uses such as the purchase of assets, especially fixed, for the production of goods and services, inventories, to facilitate production and sales as well as payment for varying transactions. What is fundamental they stated was that these sources of funds and the uses or purposes for which the funds are committed to change over time and the

process is known as funds flow. Financial management according to them therefore connotes the effective and efficient management of the flow of funds within and outside the organization.

Management employs financial analysis for purposes of internal control. In particular, it is concerned with profitability on investment in the various assets of the company and in the efficiency of asset management (Ibid: 349). Financial analysis as a role of financial analyst evolved with changes in the role of financial management. Financial management as a field of study is believed to have passed though several and significant changes over the years when it first emerged as a separate field of study from management in the year 1890. At that time emphasis was primarily on the acquisition of funds. This was so because the basic problem facing business managers and firms in the early 1900 was that of obtaining the desired capital. This focus remained through to the later parts of 1920s. However, radical changes occurred and a significant departure was recorded during the periods of the world depression of the 1930s otherwise called the great depression when an unprecedented number of businesses failed. This development necessitated a redirection of attention and effort to critical issues of the moment such as bankruptcy, corporate reorganization, corporate liquidity, the role of government and government regulations on the operation of businesses. In other words, there was shift of emphasis from corporate expansion strategies to business survival strategies. The period of 1940s through to the early parts of 1950s witnessed a redesignation of focus to basically methods of financial analysis. The intention was to help businesses maximize their total profitability, stock prices as well as predict the likelihood of failure even before it occurs.

The analysis of financial ratios indicates the operating and financial efficiency, and growth of a firm. The financial ratios could be used to determine the ability of the firm to meet its current obligations; the extent to which the firm has used its long-term solvency by borrowing funds; the efficiency with which the firm is utilizing its assets in generating sales revenue and the overall operating efficiency and performance of the firm. The job of the financial manager is, therefore, an important one and his

responsibilities involves taking decisions as regards instruments the firm should take, how these instruments should be financial and how the existing resources of the firm should be managed so that the maximum benefit could be derived.

In order to perform his functions in the most effective and efficient manner, the financial manager needs some tools of analysis. One of the tools available to the financial manager is the "Financial Ratio Analysis". Financial ratio analysis is the process of identifying the financial strengths and weaknesses of any firm by properly establishing relationship between the items of the balance sheets and the profit and loss account. A financial manager wants to know through financial analysis whether the firm can reasonably afford to borrow all or part of the funds needed to finance a planned expansion, find out causes of changes in operating income relative to its competitors etc. Financial ratio analysis is therefore, used as a means of evaluating the financial position and performance of a firm as well as product the likelihood of an organization going bankrupt.

Although financial managers cannot rely on accounting information as reported in the various financial statements as most times they do not provide adequate understanding of the performance and the actual position of a firm until when they convey meaning relating to specific information. The analysis of financial analysis can also be undertaken by outsiders for example, investors who wish to determine the credit worthiness or investment potentials of the firm.

According Pandey, (2000: 8-9), financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the items of balance sheet and the profit and loss account. Financial analysis can be undertaken by management of the firm, or by parties outside the firm, viz, owners, creditors, investors and others. The nature of analysis will differ depending on the purpose of the analysis. Trade creditors may be interested in a firm's ability to meet their claims over a very short period of time. Their analysis will therefore, confine to the evaluation of the firm's liquidity position. Suppliers of long-term debt, on the other hand, are concerned with the firm's long-term solvency and survival. They analyze the firm's profitability over time, its ability to generate cash to

be able to pay interest and repay principal and the relationship between various sources of funds (capital structure relationship). Long-term creditors do analyze the historical financial statements, but they place more emphasis on the firm's projected, or pro forma, financial statements to make analysis about its future solvency and profitability. Investors, who have invested their money in the firm's shares, are most concerned in those firms that show steady growth in earnings. As such, they concentrate on the analysis of the firm's present and future profitability. They are also interested in the firm's financial structure to the extent it influences the firm's earnings ability and risk. Management of the firm on the other hand, would be interested in every aspect of the financial analysis. It is their overall responsibility to see that the resources of the firm are used most effectively and efficiently, and that the firm's financial condition is sound.

It is imperative to note the importance of the proper context for ratio analysis. Like computer programming, financial ratio is governed by the GIGO law "Garbage In…Garbage Out!" A cross industry comparison of the leverage of stable utility companies and cyclical meaning companies would be worse than useless. Examining a cyclical company's profitability ratios over less than a full community or business cycle would fail to give an accurate long-term measure of profitability. Using historical data independent of fundamental changes in a company's situation or prospects would predict very little about future trends. For example, the historical ratios of a company that has undergone a merger or had a substantive change in its technology or market position would tell very little about the prospects for this company. Generally, a financial ratio serves as a useful tool to manager and investors in assessing the financial strengths and weaknesses of a firm. However, a single ratio in itself does not indicate favourable or unfavourable condition until it is compared with some standards. Further to the identification of the inadequacies of the univariate ratio analysis otherwise called the traditional ratio analysis, a number of empirical studies were conducted on multivariate financial analysis which can be used in the prediction of financial and corporate bankruptcy etc. Some of the standards of comparison of the traditional or univariate ratio analysis are:-

(a) Ratios computed from the past financial statements of the same firm;

(b) Ratios developed using the pro-forma financial statements of the same firm;

(c) Ratios of some selected firms especially the most progressive and successful in the same industry within the same period; and

(d) Ratios of the industry to where the firm belongs (industry average).

Financial Ratios are often evaluated using:-

(i) Cross-sectional approach; and

(ii) Time-series analysis.

Of all the tools of financial analysis, ratio analysis is perhaps the most widely used. A ratio is simply the relationship between the one number and another number. Financial ratio analysis is the calculation and comparison of ratios which are derived from the information in a company's financial statements. The level of historical trends of these ratios can be used to make inferences about a company's financial condition, its operations and attractiveness as an investment. But that surely does not mean that the resulting ratios would assist the analyst by enhancing undertaking of the firm's financial conditions. The analyst is interested only in those ratios that are relevant to particular financial problems or decisions. It is wrong to conclude from any firm's ratio that a firm's liquidity position is satisfactory or not, that its capital structure is sound or unsound, or that the ratio is too high or too low. The ratio may be symptomatic of a problem, but further analysis is required to determine the cause or to draw conclusions of a qualitative nature.

The great advantage of ratio analysis is that it reduces raw data of widely varying magnitude to a common comparative basis. Thus, ratio analysis is the most meaningful way to compare financial information regarding a given firm to that of others that are larger or smaller, or to a composite of other firms such as an industry.

Credit analysts, those interpreting the financial ratios from the prospects of a lender, focus on the "downside" risk since they gain none of the upside from an improvement in operations. They pay great attention to liquidity and leverage ratios to ascertain a company's financial risk. Equity analysts look more to the operational and profitability ratios, to determine the future profits that will accrue to the shareholder.

Although financial ratio analysis is well-developed and the actual ratios are well known, practising financial analysts often develop their own measures for particular industries and even individual companies. Analysts will often differ drastically in their conclusions from the same ratio analysis.

1.2 Statement of the Problem

Two groups of questions will be the focus of this study. The first is how effective is the financial ratio analysis?

The second question concerns prevention of effectiveness of financial ratio. Does the use of financial ratio analysis prevent corporate bankruptcy and failure? In other words are the earlier results corroborated, or have they been influenced by the limited selection of variables? In addition to the implications on the traditional financial ratios, we are interested in finding out whether the use of financial ratio analysis can help in predicting corporate bankruptcy and failure.

In tackling our research problem, we shall use a hypothesis approach rather than just observing and reporting the emerging classifications. The statistical methods will be factor analysis, and transformation analysis.

In tackling our research questions special attention must be given to stability, and avoidance of definitional correlation. One of the pitfalls of inductive methods, such as factor analysis, is whether the results are a consequence of a coincidence, and thus unstable, or do they result from true underlying factors, which would mean better stability. Hence we shall test the stability of our factor analysis results with transformation analysis.

Definitional correlation between financial ratios can easily arise if they include, either directly or indirectly, the same components (e.g. net profit/total assets and net profit/sales are related by definition). We strive to avoid this pitfall by a judicious selection of the original variables.

1.3 Objectives of the Study

The purpose of this study is to evaluate the effectiveness of financial ratios analysis in evaluation of customer credit worthiness in the banking industry, a case study of First Bank Plc. This is in order to assess how well or otherwise financial ratio analysis can assist financial managers in predicting financial problems and to enable them adequately plan for future financial resources of their organizations.

1.4 Research Question/Hypothesis

Profitability, operating efficiency, output level, capital investment and dividends are considered as measures of success of a firm. Ratio analysis is a very useful tool to raise relevant question on a number of a managerial issues. This study seeks to answer the following question:

- How effective are financial ratios analysis in evaluation of customer credit worthiness in the banking industry.
- In an attempt to answer the research question, two hypotheses have been developed. These hypotheses are null hypothesis and alternative hypothesis. The hypotheses are given as follows:-

Ho: There is no significant relationship between financial ratios analysis and prediction of corporate failure.

H1: There is significant relationship between financial ratios analysis and customer credit worthiness in the banking industry.

1.5 Significance of the Study

Ratio analysis is the most powerful tool of financial analysis. Financial analysis is the process of identifying the financial strengths and weaknesses of a firm by properly establishing relationships between the items of the Balance Sheet and the Profit and Loss Account. Financial analysis can be undertaken by management of the firm, or by other stakeholders outside the firm, viz: owners, creditors, investors and others. The relationship between two accounting figures, expressed mathematically, is known as financial ratio. Financial ratios help to summarize large quantities of

financial data and to make qualitative judgment about the firm's financial performance. It is important to note that a ratio reflecting a quantitative relationship helps to form a qualitative judgment (such is the nature of all financial ratios).

The analysis of financial ratios indicates the operating and financial efficiency, and growth of a firm. The financial ratios could be used to determine – the ability of the firm to meet its current obligations; the extent to which the firm has used its long-term solvency by borrowing funds; the efficiency with which the firm is utilizing its assets in generating sales revenue, and the overall operating efficiency and performance of the firm.

With the current political and economic difficulties in Nigeria, business enterprises are invariably subjected to pressure and stress which in effect has constituted a threat to the corporate existence of these businesses which if not properly managed could lead to bankruptcy, or even total failure. As such, financial sectors became a battlefield for survival of the fittest with financial institutions being forced to assume greater risks.

Financial ratio analysis is used to computer, analyze, predict and compare the conditions and performances of business enterprises in order to evaluate their liquidity, profitability and viability. It is against this background that this topic was chosen by the writer.

1.6 Scope of the Study

This study seeks to evaluate the effectiveness of financial ratios analysis in evaluation of customer credit worthiness in the banking industry. It also seeks to evaluate and show how financial ratios can serve as tools for managerial control. Consequently, the study covers the financial activities of First Bank.

In an attempt to evaluate these various financial statements, industry ratios using trend analysis were compared over time. Year-to-year comparisons can highlight trends and point up the need for action. Trend analysis works best with five years of ratios. The second type of ratios analysis, cross-sectional analysis, compares a company's financial ratios to industry ratio averages. Another popular forms of cross-

sectional analysis compares the financial ratios of two or more companies in similar lines of business.

1.7 Limitations of the Study

Research on financial ratios analysis is usually based on a large number of firms. But due to time constraint, this study will base its research on First Bank only. Some of the limitations of this study are:-

- Limitations of the financial ratios which could be due to alternative accounting methods – variations among companies in the application of generally accepted accounting principles may hamper comparability. Firms frequently establish a fiscal year-end that coincides with the low point in operating activity or in inventory levels. Therefore, year-end data may not be typical of the financial condition during the year. The financial statements contain numerous estimates to the extent that these estimates render the financial ratios and percentages inaccurate. Also, traditional financial statements are based on cost and are not adjusted for price-level changes.
- Although a trend may have been developed over a period of five years.
- Nigeria is yet to develop industry ratio averages with which to compare its firms' ratios. Comparison between firms' ratios with that of the industry was therefore not possible.
- Time constitutes a serious limiting factor as the study has to be concluded within a short period of time.
- Most of Nigerian firms were unwilling to release financial statement and other data.

1.8 Definition of Related Terms

- **Accounts Payable Turnover:** The number of times payables turnover during the year.
- **Accounts Receivable Turnover:** Number of times that trade receivables turnover during the year.
- **Cost of Goods Sold:** Percentage of sales used to pay for expenses which vary directly with sales.

- **Current Ratio:** The ratio between all current assets and all current liabilities.
- **Days in Account Payable:** This shows the average length of time a firm's trade payables are outstanding before they are paid (number of days at cost in payables).
- **Days in Inventory:** This shows the average number of days it will take to sell a firm's inventory (number of days at cost in inventory).
- **Days in Receivables:** This shows the average number of days it takes to collect a firm's account receivables (number of days of sales in receivables).
- **Debt Coverage Ratio:** Indicates how well cash flow covers debt and the capacity of the business to take on additional debt.
- **Debt to Equity:** The between capital invested by the owners and the funds provided by lenders.
- **Gross Profit Margin:** Indicator of how much profit is earned on firm's product without consideration of selling and administration costs.
- **Inventory Turnover:** Number of times that firm turns over (or sell) inventory during the year.
- **Net Profit Margin:** Shows how much profit comes from every naira of sales.
- **Quick Ratio:** The ratio between all assets quickly convertible into cash and all current liabilities.
- **Ratio:** Is an expression of mathematical relationship between one quantity and another as either a percentage, rate, or proportion.
- **Return on Assets:** Considered a measure of how effectively assets are used to generate a return.
- **Return on Equity:** Determines the rate of return on firm's investment in the business.
- **Sales Growth:** Percentage increase (or decrease) in sales between two time periods.
- **Sales to Total Assets:** Indicates how efficiently a firm business generates sales on each naira of assets.

CHAPTER TWO
LITERATURE REVIEW

2.1 The Concept of Financial Ratios

Financial ratios are widely used for modelling purposes both by practitioners and researchers. The firm involves many interested parties, like the owners, management, personnel, customers, suppliers, competitors, regulatory agencies, and academics, each having their views in applying financial statement analysis in their evaluations. Practitioners use financial ratios, for instance, to forecast the future success of companies, while the researchers' main interest has been to develop models exploiting these ratios. Many distinct areas of research involving financial ratios can be discerned. Historically one can observe several major themes in the financial analysis literature. There is overlapping in the observable themes, and they do not necessarily coincide with what theoretically might be the best founded areas, ex post. The existing themes include:

a. the functional form of the financial ratios, i.e. the proportionality discussion,
b. distributional characteristics of financial ratios,
c. classification of financial ratios,
d. comparability of ratios across industries, and industry effects,
e. time-series properties of individual financial ratios,
f. explaining (other) firm characteristics with financial ratios,
g. stock markets and financial ratios,
h. forecasting ability of financial analysts vs financial models,
i. estimation of internal rate of return from financial statements (Weston & Brigham, 1987: 27).

The history of financial statement analysis dates far back to the end of the previous century (Horrigan, 1968). However, the modern, quantitative analysis has developed into its various segments during the last two decades with the advent of the electronic data processing techniques. The empiricist emphasis in the research has given rise to several, often only loosely related research trends in quantitative

financial statement analysis. Theoretical approaches have also been developed, but not always in close interaction with the empirical research.

2.2 Historical Development of Ratio Analysis

The discipline of financial analysis has its roots in the principles of accounting. Historically, it was a combination of corporate reporting practices and a major depression that dictated this background. Financial analysis encompasses both security analysis and corporation finance, as these two fields can be considered to be two sides of the same coin. Security analysis has traditionally looked down upon the financial decisions of a firm from the point of view of an outsider, while corporations finance (or business finance, or financial management) has considered financial decision-making from the perspective of an operating officer. In addition, portfolio analysis has emerged from security analysis to be a discipline in its own right. Financial analysis thus appeared the most appropriate term with which to describe the intellectual framework common to all these fields of study.

In 1866 the Treasurer of the Delaware, Lackawanna, and Western Railroad Company, for example, once responded to a request for information from the New York Stock Exchange by writing, “The Delaware, Lackawanna R.R. Co. make no reports and publish no statements and have done nothing of the kind for the last five years.” By 1934, when Benjamin Graham and David Dodd wrote their classic study, Security Analysis, corporate reporting practice was much more sophisticated than this quotation suggests. Nonetheless, the level of corporate disclosure and the accounting standards in use were by no means as high as those which analysts now regard as normal. As a consequence, entire sections of Graham and Dodd’s work are devoted to the fine points of recasting a corporation’s income statement and balance sheet into more meaningful form and explaining other techniques of financial statement analysis.

Moreover, Security Analysis was first published in the era of the Great Depression, when investors had good reason to question whether a corporation with a high level of bonded indebtedness would be able to refinance its debt or meet its interest payments as they fell due. Each investor had to assess the probability of a

firm's failure. Given a historical tradition of inadequate disclosure and the peculiar liquidity problems of the depression, a premium was placed upon analysis with skill in accounting techniques.

The conditions that prevailed when Graham and Dodd wrote their work are not prevalent today, however. The corporate income tax and the heightened sophistication of the accounting profession have gradually forced most businesses to keep better records and to adopt more adequate accounting practices. In addition, the probing of security, analysts and the requirements of the Securities and Exchange Commission, as well as the various exchanges on which securities are listed, have in large measure succeeded in improving disclosure practices. Furthermore, the danger of imminent insolvency is no longer among the most pressing problems facing corporations today.

These developments have shifted the focus of the security analyst significantly. The modern financial analyst, to use a broader and more inclusive term than security analyst, is now concerned with problems such as the selection of firms that have relatively attractive investment opportunities, the evaluation of the availability of funds to finance asset expansion, and the analysis of changes in the rate at which shareholders will value future streams of income.

Incorporating Economics into Financial Analysis

Many of these problems are familiar to economists. It is not surprising, therefore, to find security analysts as well as financial officers looking beyond the traditional accounting statements for information and placing greater emphasis upon the principles of economic analysis in evaluation this data. Many of the tools of national income analysis as well as those of microeconomic theory have now been incorporated into financial analysis. Thus financial analysts typically discuss the effect of changes in national income upon the corporate rate of return and the opportunity for corporate growth, or ponder the effect of changes in the output of substitutes and complementary products on both product prices and factor costs, or consider the consequences of changes in capacity upon a firm's output and hence its rate of return.

Other forces have also helped reshape financial analysis since Graham and

Dodd wrote their monumental study. Since the end of World War II, the discipline of corporation finance has developed and made popular a large number of analytic tools, including cash budgeting, profit planning, and capital budgeting. The chief financial officer of a corporation, who is trained in these techniques, is now able to anticipate cash flows and plan the earnings of a corporation much more precisely.

This quite revolution in corporate financial management enables the security analyst who is evaluating the firm to focus his attention on the firm's expected future rate of return rather than on its past earnings stream. As a result, the determinants of the corporate rate of return now seem far more significant to the analyst than the monetary market forces which produced past random price fluctuations.

The corporate disclosure problem in the area of capital budgeting is still severe. The modern security analyst must be, like his predecessors, something of a detective. The attitude of corporations concerning the disclosure of their expected return on various projects is often reminiscent of that expressed by the Delaware and Lackawanna about disclosing their sales and earnings figures a century ago.

A second major development that has had a profound impact on the course of financial analysis is the emergence of portfolio management as a separate, distinct of study. When Graham and Dodd wrote their treatise, portfolio was considered a relative trivial topic. The theory was that if the market prices of a security were less than some predetermined price, it should be bought, and if the price was above this figure, it should be sold. With the growth of large mutual funds, expanded trust departments in commercial banks, and the rise of professional portfolio managers and investment advisors, this simple buy-sell dictum proved unsatisfactory. It seems unlikely, for example, that a large mutual fund would ever sell all its holdings in General Motors, I.B.M., or American Tel. and Tel. It might be expected to add to or subtract from its holdings at different times. Adding and subtracting at the margin raises a different set of problems altogether.

Questions never asked before began to arise. How might one obtain the maximum return from the portfolio as a whole, with a given variability in the return? What is the meaning of diversification? What kinds of risk can portfolio

diversification guard against? To answer such questions, more sophisticated techniques, such as factor analysis and quadratic programming are required. The practical application of these techniques has been made feasible by computers. Like all new developments, however, the new tools suggest as many questions as they resolve.

Analysts are now trying to sharpen these new analytical tools. The analyst wants assurance that his inputs into the analytical process are adequate and that they are designed in the most efficient, functional form possible. In short, to the large permanent investor, the relationship among the securities within a portfolio is now a matter of serious concern. For this reason portfolio management has become an important field of study in its own right.

The third major development that has influenced financial analysis is the use of abstract models in the study of the interrelationship of the firm and the market. The search for some intrinsic value, or loosely, what the stock is "really worth" (a search that is reminiscent of Marx's desire to find the "socially necessary" amount of labour power inherent in any commodity) has all but disappeared from serious analysis. Instead, the financial analyst now seeks to express the price of a security as a function of different variables. A number of such single-equation, or "unconstrained," models, of which the Value Line model is perhaps the best known, have been developed and applied with varying degrees of success. Recently, more adequate systems have been developed in which the independent variables of the price equation are themselves joined together to form side conditions, or constraints.

This type of analytical model building, replacing the intuitive analysis of each change in corporate activities in terms of its own rich institutional background, has necessarily led to the use of more formal mathematical techniques. Thus it is not surprising that knowledge of the rudiments of calculus, matrix algebra, and statistics has become an indispensable background for the financial analyst. The necessary of this background has been recognised by business schools throughout the nation, and course in these courses in these subjects are now required for all students in most universities.

2.3 Concept of Financial Ratios

Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and the profit and loss account. Financial analysis can be undertaken by management of a firm, or by parties outside the firm, viz. owners, creditors, investors and others (Foster, G., 1986: 2-7). The nature of the analysis will differ depending on the purpose of the analyst. Financial analysis is normally done through the use of mechanics of ration analysis.

Ratio analysis is a powerful tool of financial analysis. A ratio is defined as "the indicated quotient of two mathematical expressions" and as "the relationship between two or more things." In financial analysis, a ratio is used as a benchmark for evaluating the financial position and performance of a firm. The absolute accounting figures reported in the financial statements do not provide a meaningful understanding of the performance and financial position of a firm.

Financial ratio analysis is a fascinating topic to study because it can teach us so much about accounts and businesses. When we use ratio analysis we can work out how profitable a business is, we can tell if it has enough money to pay its bills or is likely to face problems in the near future. Ratio analysis can also help us to check whether a business is doing better this year than it was last year; and it can tell us if our business is doing better or worse than other businesses doing and selling the same things. The overall layout of this section is as follows: We will begin by asking the question, what do we want ratio analysis to tell us? Then, what will we try to do with it? This is the most important question. The answer to that question then means we need to make a list of all of the ratios we might use: we will list them and give the formula for each of them.

Once we have discovered all of the ratios that we can use we need to know how to use them, who might use them and what for and how will it help them to answer the question we asked at the beginning? At this stage we will have an overall picture of what ratio analysis is, who uses it and the ratios they need to be able to use it. All that is left to do then is to use the ratios; and we will do that step-by-step, one by one.

If we look at the questions asked above section, we can see that we talked about profits, having enough cash, efficiently using assets - we can put our ratios into categories that are designed exactly to help us to answer these questions. The categories we want to use, section by section, are:

- Profitability: has the business made a good profit compared to its turnover?
- Return Ratios: compared to its assets and capital employed, has the business made a good profit?
- Liquidity: does the business have enough money to pay its bills?
- Asset Usage or Activity: how has the business used its fixed and current assets?
- Gearing: does the company have a lot of debt or is it financed mainly by shares?
- Investor's or Shareholder's decision.

The basic ratios are those that everyone should use in these categories whenever we are asked a question about them. We can use the additional ratios when we have to analyse a business in more detail or when we want to show someone that we have really thought carefully about a problem.

Ratios when computed can be computed and expressed in the following ways; (a) Percentages; (b) Fractions, and (c) Relations between one variable and the other.

Research has shown that financial ratios, although not rooted in Nigeria, can be applicable to firm in this country that is organizational or financial institutions especially with the development of the Osaze's index of risk for measuring corporate growth and profitability for developing and underdeveloped economies of the world like ours. Hence the development of 'CAMEL' by the Nigerian Deposit Insurance Corporation (NDIC); a standard criteria for examination and risk assessment criteria for banks in Nigeria. The meaning of 'CAMEL' stands thus:

C = Capital Adequacy;

A = Asset quality;

M = Management ability and competence;

E = Earnings strengths; and

L = Liquidity sufficiency.

A number of measures is being taken by NDIC to address the problem of liquidity arising from banks' inability to meet their customers' obligations as at when due. The above parameters adequately cover every factor required for a sound bank management, hence the nature of distress can be determined and the severity of the ratings analysed properly.

2.4 Standards of Comparison

It should be noted that there is no such a ratio that can be called an ideal ratio. Therefore, ratio analysis involves comparison for a useful interpretation of the financial statements. A single ratio in itself does not indicate favourable or unfavourable condition. It should be compared with some standard. Standards of comparison may consist of:

a. **Past ratios,** i.e., ratios calculated from the past financial statements of the same firm;
b. **Competitors' ratios,** i.e. ratios of some selected firms, especially the most progressive and successful competitor, at the same point in time;
c. **Industry ratios,** i.e. ratios of the industry to which the firm belongs; and
d. **Projected ratios,** i.e. ratios developed using the projected, or pro forma, financial statements of the same firm.

The easiest way to evaluate the performance of a firm is to compare its present ratios with the past ratios. When financial ratios over a period of time are compared, it is known as the time series (or tend) analysis. This gives an indication of the direction of change and reflects whether the firm's financial performance has improved, deteriorated or remained constant over time (Pandey, 2000: 110).

2.5 Types of Comparison

There are three basic tools of analyzing financial tools:

O **Horizontal or Trend Analysis** – This evaluates a series of financial statement data over a period of time to determine the increase or decrease that has taken place, expressed as either an amount or a percentage. A base year is selected

and changes are expressed as percentages of the base year amount. This given an indication of the direction of change and reflects whether the firm's financial performance has improved, deteriorated or remained constant overtime. The analyst should not simply determine the change, but, more importantly, he/she should understand why ratios have changed. The change, for example, may be affected by changes in the accounting policies without a material change in the firm's performance.

- **Cross-sectional Comparative Analysis –** Another way of comparison is to compare ratios of one firm with some selected firms in the same industry at the same point in time. In most cases, it is more useful to compare the firm's ratios with ratios of a few carefully selected competitors, who have similar operations. This kind of a comparison indicates the relative financial position and performance of the firm. A firm can easily resort to such a comparison, as it is not difficult to get the published financial statements of the similar firms. Although comparative analysis is widely used, it has several potential problems. For example, operating results of companies may be interdependent, especially when these companies are in the same industry. Similar companies may also use different accounting techniques, making comparison difficult. Additionally, economics of scale or other economic factors may affect companies differently.
- **Industry Analysis –** Ratios may be compared with average ratios of the industry in order to determine the financial condition and performance of a firm. The financial standing and capability of a firm vis-à-vis other firms in the industry can be ascertained using this ratio. Industry ratios are important standards in view of the fact that each industry has its characteristics which influence the financial and operating relationships (Pandey, 2000: 147).

2.6 Classification of Financial Ratios

Ratios can be grouped into various classes according to financial activity or function. Parties interested in financial analysis are short- and long-term creditors,

owners and management. Short-term creditors' main interest is in the liquidity position or the short-term solvency of the firm. Long-term creditors, on the other hand, are more interested in the long-term solvency and profitability of the firm. Similarly, owners concentrate on the firm's profitability and financial condition. Management is interested in evaluating every aspect of the firm's performance. Management also have to protect the interests of all parties and see that the firm grows profitably. In view of the requirements of the various users of ratios, financial ratios can be classified into four important categories:

a. Liquidity ratios;
b. Leverage ratios;
c. Activity ratios; and
d. Profitability ratios (Van Horne, 2000: 365-371).

LEVERAGE RATIOS - This shows the extent that debt is used in a company's capital structure. This ratio indicates mix of funds provided by owners and lenders. Leverage ratios may be calculated from the balance sheet items to determine the proportion of debt in total financing. Many variations of these ratios exist; but all these ratios indicate the same thing – the extent to which the firm has relied on debt in financing assets. Leverage ratios are also computed from the profit and loss items by determining the extent to which operating profits are sufficient to cover the fixed charges.

LIQUIDITY RATIOS - Measure the short-term ability to pay maturing obligations and to meet unexpected needs for cash. Liquidity ratios also measure the firm's ability to meet its current obligations. Analysis of liquidity needs the preparation of cash budgets and cash and fund flow statements; but liquidity ratios, by establishing a relationship between cash and other current assets to current obligations, provide a quick measure of liquidity. A firm should ensure that it does not suffer from lack of liquidity, and also that it does not have excess liquidity. The failure of a company to meet its obligations due to lack of sufficient liquidity, will result in a poor creditworthiness, loss of creditors' confidence, or even in legal tangles resulting in the closure of the company. A very high degree of liquidity is also bad; as idle assets earn

nothing. The firm's funds will be unnecessarily tied up in current assets. Therefore, it is necessary to strike a proper balance between high liquidity and lack of liquidity.

ACTIVITY RATIOS - These ratios are employed to evaluate the efficiency with which firms manage and utilize its assets. These ratios are also called turnover ratios because they indicate speed with which assets are being converted or turned over into sales. Funds of creditors and owners are invested in various assets to generate sales and profits. The better the management of assets, the larger the amount of sales. Activity ratios, thus, involve a relationship between sales and assets. A proper balance between sales and assets generally reflects that assets are managed well. Several activity ratios can be calculated to judge the effectiveness of asset utilization.

PROFITABILITY RATIOS – These ratios are calculated to measure the operating efficiency of the firm. Apart from management of the firm, creditors and owners are also interested in the profitability of the firm. Creditors want to get interest and repayment of principal regularly. Owners want to get a required rate of return on their investment. This is possible only when the firm earns enough profits. Generally, there are two major types of profitability ratios: (i) Profitability in relation to sales, and (ii) Profitability in relation to investment (Pandey, 2000: 131).

2.7 Growth Ratio

Growth ratios measure how well the firm maintains its economic position in the economy as a whole as well as its own industry. During the recent period inflation, the interpretation of growth ratios has become more difficult. Some of the ratios that fall under this category are:

(i) Sales growth

(ii) Net income growth, and

(iii) Dividends per share.

2.8 Valuation Ratio

This is a set of ratios that helps equity shareholders and other investors to assess the value and quality of an investment in the ordinary share of a firm. These

ratios are the most comprehensive measures of performance for the firm in the sense that they reflect the combined influence of risk ratios and return ratios. These include;

1. Earnings per share
2. Dividend per share
3. Dividend Cover
4. Price earnings ratio
5. Dividend yield, and
6. Earnings yield.

The value of an investment in ordinary shares in a listed company is its market value and so investment ratios must have regard not only to information in the firm's published accounts but also to the current share price quoted on the stock exchange. Ratio (d, e, & f above) involve the use of share price.

2.9 Financial Ratios and Corporate Failure

Financial ratios are generally considered to be useful for predicting financial difficulties of firms. Previous research on the ability of financial ratios to predict business failure can be classified into two categories. The first group concentrates upon the predictive power of individual ratios based either on the ratios trend or its magnitude whereas the second category utilised the multivariate approach. Discriminant analysis researches, relying on statistical techniques, have been able to use sets of ratios to predict the survival/continuation or failure of a firm.

The works of some distinguished scholars such as Smith & Winakor (1935), Fitzpatrick (1931 and 1932), Charles L. Merwin (1942) are taken into consideration in analysing the first category. Smith and Winakor studied a sample of 183 firms which had experienced some financial difficulties during the period of 1923 to 1931 and had finally failed by 1931. They analysed the prior ten year trends of the means of 21 ratios and concluded that the ratio of net working capital to total assets whose decline began ten years before the occurrence of financial difficulties was the most accurate and steady indicator of business failure. Their data actually indicated that the long-term solvency ratios were equally good indicators. Fitzpatrick however used a

different approach by analysing the prior three to five year trends of thirteen ratios of twenty firms that have failed during the period 1920 to 1929. He (Fitzpatrick) studied the data on a case-by-case method of analysis and followed it up by comparative analysis of a matched sample of nineteen successful firms. He however concluded that all his ratios predicted failure to some extent through declining trends but also stated that his best predictors were the net profit to net worth ratio and the net worth to total debt ratio.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Population of the Study

This study aims at evaluating and interpreting the performances of financial ratio analysis in customer credit worthiness in the banking industry. For this purpose, First Bank of Nigeria Plc was randomly selected. Financial ratios were applied on the financial statements of the selected bank in order to assess and measure the possibility of the bank going bankrupt.

3.2 Sample Size

The bank used for this study was strategically selected. In assessing and measuring the performance and effectiveness of the selected bank.

3.3 Sample Selection/Sampling Technique

The bank selected was studied. The period chosen was due to the intense nature of competition amongst banks providing various ranges of financial services to their numerous customers. Banks in Nigeria now find themselves in fierce competition all trying to attract, capture and maintain a large number substantial and existing share of the customers available to them. This is necessary especially given the slump in the economic trend of the country. The study therefore, tried to evaluate the use of financial ratios as well as their impact and particularly to device strategies to suit the peculiarities and situation of the chosen bank. As earlier mentioned, the bank selected is: First Bank Plc.

3.4 Data Collection

Data were recorded and observations about phenomenon are being studied (Naechmias & Naechmias, 1982). It is usual to distinguish between qualitative and quantitative data. This is thus the first puzzle encountered in practical data collection. Qualitative and quantitative methods are to produce qualitative and quantitative data respectively. The distinction between qualitative and quantitative methodology has

been elaborated in social science researches notably in sociology and evaluation, education, human resource management and in organizational sciences (Evered and Louis, 1981).

Quantitative methodology is easily illustrated as an approach which applies a natural scientific approach to the conduct of research of a social phenomenon. Operational definitions, objectivity, replicability, and causality are its characteristics. The survey method exemplifies this tradition to the extent that it can apparently be readily adapted to such concerns. By means of questionnaires, conceptualized items can be measured; objectivity is maintained by the reliability of one's questionnaires; replication can be carried out by using the same research instrument in another setting. Other than surveys, experimental and quasiexperimental designs and exposte analyses of secondary information (i.e., of precollected data) are also accepted as, exhibiting the same underlying characteristics.

Qualitative methodology differs in a number of ways. The objective here is to see the social world from the point of view of the actor, a theme which pervades the methodology writings within this orthodoxy. Close involvements with the subjects are emphasized. Qualitative research is said to be more flexible than quantitative research to the extent that the emphasis is on discovery of novel or unanticipated findings and the possibility of changing the research plans as unanticipated events occur. This is contrasted sharply with the quantitative investigator's design which emphasise; fixed measures, test of hypotheses, and a somewhat relatively hurried fieldwork. Qualitative researchers often claim that they produce data which are often considered 'rich' (Evered and Louis, 1961) by which is meant data with a great deal of depth.

In contrast, survey data are seen as deficient in this respect, to the extent that they provide only superficial evidence on the social world; extracting the causal relationship between arbitrarily selected variables which have little or no meaning to those individuals whose social worlds they are meant to represent. The validity of a research is the extent to which the data collected are relevant to the problem of the research. No data need be collected unless they are related to the problem. The data must provide exactly the information that is sought from the respondents.

3.5 Method of Data Analysis

In this study, the researcher used a total number of 21 ratios. These were classified into six major groups as:

1. **Liquidity Ratios:** Financial ratios in this category measure the company's capacity to pay its debts as they become due. They include ratios such as:
    (i) Current ratio
    (ii) Quick ratio
    (iii) Cash Ratio
    (iv) Interval Measure
    (v) Net Working Capital Ratio
2. **Leverage Ratios:** These ratios show the extent that debt is used in a company's capital structure. Ratios under this category include:
    (i) Debt ratio
    (ii) Debt-Equity ratio
3. **Activity Ratios:** Ratios under this category use turnover measures to show how efficient a company is in its operations and use of assets. Under this category, we have:
    (i) Inventory turnover
    (ii) Total assets turnover
    (iii) Accounts Receivable Turnover
    (iv) Fixed Assets Turnover
    (v) Current Assets Turnover
4. **Profitability Ratios:** The ratios in under this category measure the ability of the business to make a profit. The ratios under category include:
    (i) Net profit Margin
    (ii) Operating expenses ratio
    (iii) Return on Equity
    (iv) Earnings per Share

5. **Growth Ratios**: This category of ratios measures how well the firm maintains its economic position in the economy as a whole as well as its own industry. They include:

(i) Sales growth

(ii) Net income growth, and

(iii) Dividends per share.

6. **Valuation Ratios:** These ratios help equity shareholders and other investors to assess the value and quality of an investment in the ordinary share of a firm. Ratios under this category include:

(i) Earnings per share

(ii) Dividend per share

(iii) Dividend Cover

(iv) Price earnings ratio

(v) Dividend yield, and

(vi) Earnings yield

CHAPTER FOUR
RESULTS AND DISCUSSION

The results of the data collected in respect of this investigation were presented and discussed in this chapter. Data presented in tabular form was discussed for the purpose of the study.

4.1 Presentation of Results

This chapter deals with the result and discussion of the research work. It also deals with the description of the analysis of the data obtained from the research. The analysis of the data will help investigation to conform to the validity and reliability.

The data were analyzed using percentage value. The research questions were used as framework for analysis.

Question 1: How effective is financial ratios analysis in evaluation of customer credit worthiness in the banking industry?

Respondents	Number of Respondents	Percentage (%)
Very effective	80	80%
Not effective	20	20%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that financial ratios analysis in evaluation of customer credit worthiness in the banking industry has effective which represents 80% while 20% of the respondents do not agreed to the statement.

Question 2: Do financial ratios predict the likelihood of a customer defaulting on a loan?

Respondents	Number of Respondents	Percentage (%)
Yes	95	95%
No	5	5%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above shows that majority of the respondents agreed that financial ratios can predict the likelihood of a customer defaulting on a loan which represents 95% while 5% of the respondents do not agreed to the statement.

Question 3: Does the quality and completeness of financial data impact the reliability of ratio analysis?

Respondents	Number of Respondents	Percentage (%)
Yes	95	95%
No	5	5%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above shows that majority of the respondents agreed that the quality and completeness of financial data significantly impact the reliability of ratio analysis which represents 95% while 5% of the respondents do not agreed to the statement.

Question 4: Does ratio analysis compare to other credit evaluation methods?

Respondents	Number of Respondents	Percentage (%)
Yes	75	75%
No	25	25%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above shows that majority of the respondents agreed that ratio analysis is a valuable credit evaluation method which represents 75% while 25% of the respondents do not agreed to the statement.

Question 5: Do economic conditions (e.g., recessions, interest rate changes) affect the accuracy of financial ratios in predicting creditworthiness?

Respondents	Number of Respondents	Percentage (%)
Yes	90	90%
No	10	10%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above shows that majority of the respondents agreed that economic conditions significantly impact the accuracy of financial ratios in predicting creditworthiness which represents 90% while 10% of the respondents do not agreed to the statement.

Question 6: Are technological advancements (e.g., machine learning, big data analysis) impacting the use and effectiveness of ratio analysis?

Respondents	Number of Respondents	Percentage (%)
Yes	95	95%
No	5	5%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above reveals that majority of the respondents agreed that technological advancements like machine learning and big data analysis are significantly impacting the use and effectiveness of ratio analysis which represents 95% while 5% of the respondents do not agreed to the statement.

Question 7: Which financial ratios are most effective in identifying credit risks?

Respondents	Number of Respondents	Percentage (%)
It includes: debt-to-equity ratio, interest coverage ratio, debt-to-capital ratio, and the non-performing loan (NPL) ratio	95	95%
No	5	5%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above indicates that majority of the respondents agreed that debt-to-equity ratio, interest coverage ratio, debt-to-capital ratio, and the non-performing loan (NPL) ratio are financial ratios in identifying credit risks which represents 95% while 5% of the respondents do not agreed to the statement.

Question 8: The borrower's character, capacity to repay, and the availability of collateral and other assets are parts of factors (beyond ratios) that are important in assessing creditworthiness?

Respondents	Number of Respondents	Percentage (%)
Yes	85	85%
No	15	15%
Total	**100**	**100%**

Source: *- Research Survey, 2025.*

The table above shows that majority of the respondents agreed that the borrower's character, capacity to repay, and the availability of collateral and other assets are parts of factors (beyond ratios) that are important in assessing creditworthiness which represents 85% while 15% of the respondents do not agreed to the statement.

Question 9: Are there industry-specific financial ratios or considerations that are more relevant for certain types of businesses or borrowers?

Respondents	Number of Respondents	Percentage (%)
Yes	90	90%
No	10	10%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that industry-specific financial ratios and considerations are indeed more relevant for certain businesses or borrowers which represents 90% while 10% of the respondents do not agreed to the statement.

Question 10: How can financial ratios help identify patterns and trends in financial data that suggest a higher risk of default?

Respondents	Number of Respondents	Percentage (%)
A low debt service coverage ratio (DSCR) or a declining profit margin could indicate a borrower's difficulty in repaying debt	95	95%
I don't have idea of how financial ratios help identify patterns and trends in financial data that suggest a higher risk of default	5	5%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above reveals that majority of the respondents agreed that financial ratios can help identify patterns and trends through low debt service coverage ratio (DSCR) or a declining profit margin could indicate a borrower's difficulty in repaying debt which represents 95% while 5% of the respondents do not have any idea to the statement above.

Question 11: How can financial ratios provide valuable insights?

Respondents	Number of Respondents	Percentage (%)
Financial ratios provide valuable insights by offering a quick and easy way to analyze a company's financial health and performance	90	90%
Ni idea	10	10%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above indicates that majority of the respondents agreed that financial ratios provide valuable insights by offering a quick and easy way to analyze a company's financial health and performance which represents 90% while 10% of the respondents do not have any idea to the statement.

Question 12: What plays a crucial role in financial ratios?

Respondents	Number of Respondents	Percentage (%)
Financial ratios rely on accurate and relevant data from a company's financial statements for their calculation and analysis	100	100%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that financial ratios rely on accurate and relevant data from a company's financial statements for their calculation and analysis which represents 100%. Therefore, all respondents agreed to the statement.

Question 13: Financial ratio analysis is a valuable tool for assessing a customer's creditworthiness in the banking industry?

Respondents	Number of Respondents	Percentage (%)
Yes	97	97%
No	3	3%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that financial ratio analysis is a valuable tool for assessing a customer's creditworthiness in the banking industry which represents 97% while 3% of the respondents do not agreed to the statement due to low knowledge.

Question 14: Ratios offer a standardized way to compare a company's financial performance to industry benchmarks, past performance, and competitors?

Respondents	Number of Respondents	Percentage (%)
Yes	95	95%
No	5	5%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that ratios offer a standardized way to compare a company's financial performance to industry benchmarks, past performance, and competitors which represents 95% while 5% of the respondents do not agreed to the statement.

Question 15: Are all operational and procedural manuals in place? (e.g., Credit, Treasury, Operations, Job Descriptions, etc)

Respondents	Number of Respondents	Percentage (%)
Yes	100	100%
Total	**100**	**100%**

Source: - *Research Survey, 2025.*

The table above shows that majority of the respondents agreed that all operational and procedural manuals (e.g., credit, treasury, operations, job descriptions, etc) are in place which represents 100%.

4.2 Discussion

Financial analysis is the process of identifying the financial strengths and weaknesses of a firm by properly establishing a relationship between the items of the balance sheet and those of profit and loss account. Ratio analysis is a very useful analytical technique to raise pertinent questions on a number of managerial issues. It provides bases or clues to investigate such issues in detail.

In analysing and applying financial ratios of firms or organisations, some caveat has to be observed. The analyst should avoid using rules of thumb indiscriminately for all industries. For example, the criterion that all companies should have at least 2-to-1 current ratio is inappropriate. The analysis must be in relation to the type of business in which the firm is engaged and to the firm itself. The true test of liquidity is whether a company has the ability to pay its bills on time. Many sounds companies, including electric utilities, have this ability despite current ratios substantially below 2 to 1. It depends on the nature of the business. Only by comparing the financial ratios of one firm with those of similar firms can one make a realistic judgment.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the items of balance sheet and the profit and loss account. Financial analysis can be undertaken by management of the firm, or by parties outside the firm, viz: owners, creditors, investors and others (Pandey, 2000: 108).

The nature of analysis differs depending on the purpose of the analyst. To trade creditors, their interest is in firm's ability to meet their claims over a very short period of time. Their analysis will, therefore, confine to the evaluation of the firm's liquidity position. Suppliers of long-term debt, on the other hand, are concerned with the firm's long-term solvency and survival. They analyse the firm's profitability over time, its ability to generate cash to be able to pay interest and repay principal and the relationship between various sources of funds (capital structure relationships). Long-term creditors do analyse the historical financial statements, but they place more emphasis on the firm's projected, or pro forma, financial statements to make analysis about its future solvency and profitability. To the investors, who have invested their money in the firm's shares, their interests are most concerned about the firm's earnings. They restore more confidence in those firms that show steady growth in earnings. As such, they concentrate on the analysis of the firm's present and future profitability. They are also interested in the firm's financial structure to the extent it influences the firm's earnings ability and risk. Management of the firm on the other hand, would be interested in every aspect of the financial analysis. It is their overall responsibility to see that the resources of the firm are used most effectively and efficiently, and that the firm's financial condition is sound (Pandey, 2000: 109).

5.1 Summary

A financial ratio is a relationship between two financial variables. It helps to ascertain the financial condition of a firm. Ratio analysis is a process of identifying

the financial strengths and weaknesses of the firm. This may be accomplished either through a trend analysis of the firm's ratios over a period of time or through a comparison of the firm's ratios with its nearest competitors and with the industry averages.

The four most important financial dimensions which a firm would like to analyse are: liquidity, leverage, activity and profitability. Liquidity ratios measure the firm's ability to meet current obligations, and are, calculated by establishing relationships between current assets and current liabilities. Leverage ratios measure the proportion of outsiders capital in financing the firm's assets, and are calculated by establishing relationships between borrowed capital and equity capital. Activity ratios reflect the firm's efficiency in utilising its assets in generating sales, and are calculated by establishing relationships between sales and assets.

Profitability ratios measure the overall performance of the firm by determining the effectiveness of the firm in generating profit, and are calculated by establishing relationships between profit figures on the one hand, and sales and assets on the other (Pandey, 2000: 155).

Financial ratios can be derived from the balance sheet and the income statement. They are categorised into five types: liquidity, debt, coverage, profitability, and market value. Each type has a special use for the financial or security analyst. The usefulness of the ratios depends on the ingenuity and experience of the financial analyst who employs them. By themselves, financial ratios are fairly meaningless; they must be analysed on a comparative basis.

A comparison of ratios of the same firm over time uncovers leading clues in evaluating changes and trends in the firm's financial condition and profitability. The comparison may be historical and predictive. It may include an analysis of the future based on projected financial statements. Ratios may also be judged in comparison with those of similar firms in the same line of business and, when appropriate, with an industry average. From empirical testing in recent years, it appears that financial ratios can be used successfully to predict certain events, bankruptcy in particular. With this

testing, financial ratio analysis has become more scientific and objective than ever before, and we can look to further progress in this regard.

Additional insight is often obtained when balance sheet and income statement items are expressed as percentages. The percentages can be in relation to total assets or total sales or to some base year called common size analysis and index analysis, respectively, the idea is to study trends in financial statement items over time (Van Horne, 2002: 371-372).

5.2 Conclusion

The success or failure of any organisation depends on the outcome and quality of the decisions taken by management of that organisation. Decision making becomes more vital when it concerns finance because a faulty decision in the area of finance could spell doom for the organisation. For example, in periods of recession when business failures were common, the balance sheet takes an increase importance because the question of liquidity is uppermost in the minds of many in the business community. Likewise, when business conditions are good, the income statement receives more attention as people become absorbed in profit possibilities.

The importance of financial decision making in firms has become imperative for managers to rely more on evaluative techniques to provide them with hard and reliable facts on which to base their decisions. Business decisions are made on the basis of the best available estimates of the outcome of such decisions. The purpose of financial analysis is to provide information about a business unit for decision making purposes, and information needs not be limited to accounting data. While ratio and other relationships based on past performance may be helpful in predicting the future earning performance and financial health of a company, readers must be aware of the inherent limitations of such data. Financial statements are essentially summary records of the past and readers must go beyond the financial statements and look into the nature of the firms, its competitive position within the industry, its product lines, its research expenditure and above all, the quality of its management. Therefore,

researchers must examine both qualitative and quantitative data in order to ascertain the quality of earnings and the quality and protection of assets.

In the analysis of financial statements of the selected banks, ratios no doubt are perhaps the most accurate and reliable financial evaluative tools available to managers for making effective decisions. After subjecting the financial statement of the selected banks to ratio analysis, it has become clear that ratios can be employed as tools for management decisions, appraisal of business performance, predictors of business failures and forecasting difficulties and prospects of a firm over a wide range of time. Ratios provide the manager with facts about what has happened, what is happening and what is likely to happen in the future. With such information, the manager can plan his strategies to deal with given situations more effectively and efficiently.

5.3 Recommendations

Based on the findings of this research work, the following recommendations are made by the researcher. After analysing the financial statements of the selected firms using both univariate and multivariate ratio analysis over a five year period, it is evident that some of the banks have some problems regarding some single ratios, but on a combined effect assessment, all the banks have performed fairly well. Based on the findings of this research, the following recommendations are made:

1. It is therefore recommended the management of the bank should place a feasible and realistic credit and collection policies and encourage more customers to banks with them.
2. The management of the bank should also embark on policies that will encourage patronage from customers as well as settling their debts on time.
3. The net profit level when compared with the Gross profit level is very low. This indicates that either expenses are high or there is increase in taxation. Analysis shows that the selected bank operating expenses has increased greatly. Based on these, the management of the bank should minimize their cost of operations.

4. The return on investments and net worth respectively were very low. It is therefore recommended that the management of the bank under study should carefully analyze all their assets both fixed and current and their subsidiaries with a view to selling off those considered as not contributing enough to their asset mix targets.
5. Apart from First Bank Plc, all the banks finance their operations with a total debt level of well over 50% of the total assets. This means that a lot of interest charges are paid annually to creditors. This equally implies that the banks will have difficulties in seeking for much needed external financing when the need arises. Consequently, it is recommended that the companies should seek means of reducing their total debt level as this will reduce their provision for liabilities and charges as well as clear tax liabilities that are outstanding which dominate their entries for amount due to creditors over a year.
6. Based on Osaze's index, most of the banks fall in the gray area which means that the management should look into its competence, abilities and capabilities and conduct the affairs of the banks in accordance with changing conditions and respond to environmental changes.

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