

RATIO ANALYSIS

Ratio Analysis is a widely used tool of financial analysis. The term ratio in it refers to the relationship expressed in mathematical terms between two individual figures or group of figures connected with each other in some logical manner and are selected from financial statements of the concern. The ratio analysis is based on the fact that a single accounting figure by itself may not communicate any meaningful information but when expressed as a relative to some other figure, it may definitely provide some significant information. The relationship between two or more accounting figures/groups is called a financial ratio. A financial ratio helps to express the relationship between two accounting figures in such a way that users can draw conclusions about the performance, strengths and weaknesses of a firm. Ratio analysis is not just comparing different numbers from the balance sheet, income statement, and cash flow statement. It is comparing the number against previous years, other companies, the industry, or even the economy in general. Ratios look at the relationships between individual values and relate them to how a company has performed in the past, and might perform in the future. All stakeholders within the company need to be able to appreciate how the company is performing. Their understanding of how the firm is performing is enhanced through ratio analysis.

TYPES OF RATIOS

Broadly speaking, the operations and financial position of a firm can be described by studying its short term and long term liquidity position, profitability and its operational activities. Therefore, ratios can be classified into following four broad categories:

- (i) Liquidity Ratios
- (ii) Capital Structure/Leverage Ratios
- (iii) Activity Ratios
- (iv) Profitability Ratios.