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PROFITABILITY RATIO AS A TOOL OF FINANCIAL PERFORMANCE APPRAISAL
(A CASE STUDY OF HINDUSTAN UNILEVER LTD.)

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ABSTRACT

The financial performance of an organization is influenced by several factors like cost, revenue, capital structure and the consequential profit margin. The main object of present study is to identify the financial strengths and weakness of the Hindustan unilever ltd by properly establishing relationships between the balance sheet and profit & loss account. In this study we analyzed the financial performance of HUL on the parameter such as profitability, utilization of assets, and growth of performance, financial strength and capital structure. This study was under taken to find out the relevance of profitability to business performance and also to provide means by which profit can be maximized. The study investigated the technique put in place by an organization to maximize profit and recommended ways by which improvement could be made. The study has been undertaken for the period of five years from 2011-12 to 2015-16 and the necessary data have been obtained from annual reports. The liquidity position was strong of the company under study which reflect the ability of the company to pay short term obligations on due dates. Financial stability of the company has showed a downward trend. The study exclusively depends on the published financial data. This is a major limitation of the research. The study is of crucial importance to measure the firm's liquidity, solvency, profitability, stability and other indicators that the business is conducted in a rational and normal way, ensuring enough returns to the shareholder to maintain at least its market value.

***KEYWORDS**: Profitability Ratio, Cost & Revenue, Profit Margin, Performance Indicators.*

Introduction

Financial performance analysis is the process of determining the operating and financial characteristics of a firm from accounting and financial statements. The goal of such analysis is to determine the efficiency and performance of firm's management as reflected in the financial records and reports. The analyst attempts to measure the firm's liquidity, profitability and other indicators that the business is conducted in a rational and normal way, ensuring enough returns to the shareholders to maintain at least its market value. Financial management is to achieve desired tradeoff between liquidity, solvency and profitability. The management of working capital in terms of liquidity and profitability management are essential for sound financial recital as it has a direct impact on profitability of the company. The ultimate goal of profitability can be achieved by efficient use of resources. It is concerned

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with maximization of shareholder's or owner's wealth. It can be attained through profitability ratio analysis. Financial performance means firm's overall financial health over a given period of time. The ability of an organization to analyze its financial position is essential for improving its competitive position in the marketplace. Through a careful analysis of its financial performance the organization can identify opportunities to improve performance of the department, unit or organizational level.

Factors Affecting the Profitability

The following factors affect the profitability of a business concern:

- Size of the capital invested or employed
- Capital turnover
- Profit margin
- Revenue and cost
- Productivity of the concern
- Capacity utilization
- Technology changes
- Social & political factors

Objectives of the Study

The main objectives of the present work are to make a study on the overall profitability analysis of Hindustan unilever's ltd. More specifically it seeks to dwell upon mainly;

- To assess the liquidity and profitability position and trend
- To know the efficiency of financial operations
- To analyze the factors determining the behavior of liquidity and profitability

Research Methodology

The present study covers HUL a listed company on BSE. The sample of the company has been selected on a convenient basis and the necessary data have been obtained from annual reports. The study has been undertaken for the period of five year form 2011-12 to 2015-16. In order to analyze financial performance in terms of profitability and financial efficiency, Solvency, various profitability ratios have been used. In the study various statistical measures have been used i.e. arithmetic mean, standard deviation, coefficient of variation.

Profitability Ratio Analysis

Profitability ratio analysis provides relative measures of the company's performance and can indicate clues to the underlying financial position. For measuring financial position and financial efficiency and appropriate level of financial performance indicators are required with whom comparison can be made. Generally return on capital employed, net profit (margin) ratio, return on long term investment and return on equity share holder's fund are highly useful in determining financial performance and the financial stability of company.

- ***Return on Capital Employed (ROCE) Ratio:*** To measure the efficiency of a business profit should be studied in relation to the amount of capital employed; the return on capital employed is a simple method of measuring the profitability of a concern. It is widely used in measuring the overall performance of concern. The basic formula is:

  Return on capital employed =(Net profit before interest & tax/capital employed) X100

This formula is based on two important factors via rapidity of the turnover of investment and operating profit margin. There is a triangular relationship between sales, operating income (EBIT) and operating assets. It would be expressed as:

Profitability = (Sales/Operating assets) X (Operating income/Sales)

i.e. = Operating income /Operating assets

Operating assets is used to describe the net capital employed and operatingIncome as the earnings before interest & tax in a business to assess the overall profitability of a concern, the return on capital employed is calculated. The return on capital employed ratio of HUL selected for the study has been presented in table as under:

Table 1

Return on capital employed of HUL 2011-12 to 2015-16 (in Percentage)

Year	Percentage of ROCE
2011-12	95.36
2012-13	155.28
2013-14	140.05
2014-15	139.22
2015-16	141.73
Arithmetic means ($\bar{x}$)	134.328
STD. deviation (σ)	22.74
Coefficient of variation (in %)	16.93%

Sources: - Annual reports of the HUL 2011-12 to 2015-16.

The table 1 represents data relating to the ROCE of the HUL Company Selected for the Present Study. The table manifests that the ROCEis not satisfactory in the year 2011-12 which is 95.36 % as comparison of average ROCE of 5 yeas IE. 134.32 %.In the year of 2012-13 the ROCE is highest in the study period which is 155.28%. The coefficient of variation is very low i.e.16.93% which shows lower variability. The C.V represents stability or consistency of ROCE of HUL during the Study period.

- ***Net profit (margin) Ratio:*** The net profit (margin) ratio is the first profitability ratio in relation to sales in the profit margin. It is calculated by dividing the operating profit by the net sales. It is represented as follows:

  Net profit (margin) ratio = (operating ratio/net sales) X 100

It is indicative of the management ability to operate business with sufficient profits. This ratio is of vital importance to gauging business results.The net profit (margin)ratio of HUL Selected for the present study has been shown in table 2 as under:

Table 2

Net profit (margin) ratio of HUL2011-12 to 2015-16 (in Percentage)

Years	Percentage of net profit to sales
2011-12	11.97
2012-13	14.24
2013-14	13.57
2014-15	13.72
2015-16	12.36
Arithmetic means ($\bar{x}$)	13.17
Std. Deviation (σ)	0.962
Coefficient of Variation (in %)	7.305%

Source: Annual reports of the HUL, 2011-12 to 2015-16.

It is evident from the above table that the average profit margin ratio is 13.17 and the company improved its profit margin ratio in the year 2013-14 & 2014-15 which were 13.57% and 13.72 % respectively. The low standard deviation of net profit (margin) ratio i.e. 0.962 indicates that the performance of company was better in the study period. The coefficient of variation of net profit (margin) ratio is shows more consistency during the study period. It helps management to make stable dividend policy.

- ***Return on Long Terms Investment Ratio:*** Return on long term investment ratio is used by financial analysis to ascertain the best investment plans. It is also an important tool used by investor and shareholders, while making investment decision. Return on long term investment ratio for a company shows how much profit a company is making against the investment made by the shareholders and the investors. It is also used to compare different investment options by an investment advisor. It is very use full measure of the profitability of all financial resources invested in a company's assets. It evaluates the use of total funds without any regard to the sources of funds. The ratio has been calculated as follows:

  Return on long term investment (ROLTI) = {(net profit after taxes + interest)/ (net worth + long term borrowings)} X 100

On the basis of this ratio the management is able to take decisions relating to long term investment and capital expenditures. The return on long terms investment ratios of HUL selected for the study have been presented in table 3 as under:

Table 3

Return on long term investment of HUL 2011-12 to 2015-16 (in Percentage)

Years	Percentage of ROLTI
2011-12	95.36
2012-13	156.16
2013-14	141.52
2014-15	140.46
2015-16	149.25
Arithmetic means ($\bar{x}$)	136.55
Std. Deviation (σ)	23.88
Coefficient of Variation (in %)	17.49%

Source: annual reports of the HUL 2011-12 to 2015-16

The table represents data relating to the return on long term investment ratio of the HUL Company. Table 3 exemplifies that return on long term investment ratio of HUL is very higher as its average i.e. 136.55% in the whole study period. It indicates more wealth for the shareholder's or investor's of HUL. Coefficient of variation of return on long term investment ratio of HUL is 17.49% which shows more consistency during the study period. Whereas lesser variability in the return on long term investment ratio indicates proper or efficient management of wealth.

- ***Return on Equity Shareholder's Fund:*** It is another aspect to be considered in the analysis of overall profitability in the rate of return on equity capital which relates the net profit available to equity shareholder's to the amount of capital invested by them. For the purpose of the return on equity shareholders fund Net profit after deducting taxes and dividends due to preference shareholder's are consider. The ratio has been calculated as follows:

  Return on equity shareholder's fund (ROESF) = <u>Net profit after Tax – Preference dividend X 100</u>

  Equity shareholder's fund

On the basis of this ratio the management is able to take decision relating to return on equity shareholders& Dividend payout. The returns on equity shareholder's fund ratio of the HUL for the study period have been presented in table 4 as follows:

Table 4

Return on equity shareholder's fund of HUL 2011-12 to 2015-16 (in %)

Year	Percentage of ROESF
2011-12	75.82
2012-13	133.68
2013-14	111.56
2014-15	108.50
2015-16	102.80
Arithmetic means ($\bar{x}$)	106.47
Std. deviation (σ)	20.756
Coefficient of Variation (in %)	19.49%

Source: Annual reports of the HUL, 2011-12 to 2015-16

The Table 4 represents the return on equity shareholder's fund of HUL. It was very low in 2011-12 i.e. 75.82. The average return on equity shareholder's fund of HUL is 106.47% in the study period. The standard deviation of return on equity shareholder's fund ratio is 20.756 during the study period which is very high & indicates the higher volatility in ratio. Initially the company's return on equity shareholder's ratio was very low in 2011-12which was 75.82%, but it increased up to 133.68% in the year 2012-13, which is the highest during the study period but after 2013-14 it's continuously decreased up to the final year of the review period i.e. 2015-16.

Limitations of the Study

The study suffers from certain limitations:

- Study exclusively depends on the published financial data so it is subject to all limitations that are inherent in the condensed published financial statements.
- The study covers a period of only five years from 2011-12 to 2015-16. The data collected is only for one company and this might not be true representation of the population.
- The statistical tools used in the study are mainly used in the comparative analysis of data between two or more companies.

Conclusion

From the study of the profitability ratio of the HUL it can be concluded that the financial position of HUL was strong during the study period. The sales of company are increasing during the study period by the Net profit (margin) was not increasing in proportionate term. The return on equity shareholder's fund showed a downward trend and consequently the financial stability has been decreasing at an intense rate. From an investor's perspective, return on equity shareholder's fund is a key ratio. The HUL return on equity shareholder's ratio is an average 106.47% during study period. The overall financial position of HUL is better. It can be assumed that in the future, the growth of the HUL in FMCG sector will be continuously increases.

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