

FINANANCIAL ANALYSIS AND PERFORMANCE AND POSITION OF A
FIRM

CASE STUDY: UCHUMI SUPERMARKET LIMITED (NAIROBI)

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The research project submitted to the School Of Business And Management for the
Partial fulfillment and Award of Bachelor Degree in Business Administration of Kampala
International University.

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DECLARATION

I Sylvia Akinyi Osaka declare that this is my original work and it has never been produced by anyone in any other university.

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STATEMENT OF APPROVAL

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Acronyms

IFRS - International Financial Reporting Standards

GAAP - generally accepted accounting principles

SEC - Securities and Exchange Commission

FASB - Financial Accounting Standards Board

IASCF - International Accounting Standard Certified finance

EPS - earnings per share

GASB - Governmental Accounting Standards Board

IAS - International Accounting Standard

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ABSTRACT

The study was conducted to determine the relationship of financial analysis and financial performance and position of the firm. The study sought to determine how Ratios and financial statements could be used to interpret the position and performance of a firm.

Interviews helped the researcher to collect the necessary data from management that could not be obtained through the questionnaires. The data was mainly collected using questionnaire and interviews methods and analyzed using ratio analysis techniques to show if there is any relationship between financial analysis and performance and position of firm.

From the analysis, it was found that there is a significant relationship between these variables. Different ratios: Liquidity, Profitability, Gearing, Activity, and financial statements under period of study showed the declining performance of Uchumi and finally collapse.

It was therefore concluded that there are some factors, other than ratio analysis, which are affecting firm's performance significantly and should be taken into consideration in the financial analysis of firm.

It was then recommended that extra efforts and emphasis should be put on analysis of the performance of the economy, where companies should include Z – score to predict whether the company will go into bankruptcy and also an international standard of ratio analysis should be established.

CHAPTER ONE

1.0 Introduction

Globalization and integration of the world's economy has increased complexity and competition, the critical task for the managers is to match or surpass the competition both nationally and globally, as well as managing profitability through better financial performance. In many real life situations managers have little time to weigh their business funds sources options and mostly make snap decision based on minimal information, perceptions, past experiences and instincts.

In other cases, such as sale of shares, retained earnings, loans from non-banking financial institutions, managers will need to invest time, skills and effort before making a particular choice that could have a major impact on the company's performance and position. Although many organizations attribute their performance to sales, financial statement reports, surveys have indicated that few organizations have institutionalized the tools for analyzing financial and position of the firm.

1.1 Background of the topic

Many companies have been set up to achieve several objectives but the main one is to make profits. However this has been extended to maximize the shareholders wealth (BPP, 2004). Looking at other subsidiary objectives like meeting the needs of other interested parties, the question is whether the firm is able to achieve all the intended objectives.

It may be difficult to achieve high profits while being socially responsible as social responsibility involves additional costs and hence the reduced profits. The main idea here is that somehow, the

overall performance and position of a firm is affected by many factors especially in relation to achieving the primary objectives.

How do we measure the financial performance and position of the firm? The recommended approach in addition to the critical analysis of financial statements is by use of ratios (BPP, 2004). Ratios may be used to get an indicator of how the firm is performing (profitability) and the financial position (asset base, shareholders wealth and liabilities).

They are also used to highlight areas of weakness and strength and position of the firm, (Uchumi supermarket Limited in Nairobi, Kenya.)

1.2 History and Background Of Uchumi Supermarkets Limited.

Uchumi Supermarkets Limited (a locally controlled company) is one of the largest commercial retailing companies in Kenya, employing over 1,500 employees and having about 30 branches of retail supermarkets locally. It also has subsidiaries locally and in Kampala, Uganda.

The company was incorporated in 1975 and started trading in 1976. Its shares were listed on the Nairobi Stock Exchange in 1992. Since commencing trading in 1976, Uchumi Supermarkets Limited has been one of the fastest growing retail companies over the 30 years as reflected by the number of branches over the period. It is the only supermarket company that is quoted and the closest rival (Nakumatt Supermarket Limited) has a few branches in the major towns in Kenya.

From year 2001, press reports indicated that the company had started experiencing a decline in profitability and became loss making. By year 2004, the company was on the brink of collapse and a restructuring strategy was undertaken by the directors to try and reverse the process.

Currently the company has declared a rights issue to raise additional capital and improve on its liquidity position.

1.3 Statement of the problem

In assessing the performance and position of an entity, ratio analysis is the first step. It removes some of the mystique surrounding the financial statements and makes it easier to pinpoint items that would be interesting to investigate further. They are quite useful in reviewing trends for financial analysis (Business accounting 2, 2002). Ratio analysis methods are a useful guide for the financial analysis of the Audited Financial Statements of different business entities.

It is important to note that even though ratios serve as crucial indicators, by themselves they will not guarantee success in financial analysis. This research was therefore being undertaken to evaluate the impact of financial analysis on the performance of a firm, Uchumi Supermarket Limited.

1.4 The purpose of the study

The purpose of the study was to establish the relationship of financial analysis using ratios and the performance and position of Uchumi supermarket in Kenya.

1.5 Research objectives

The research intended to achieve the following objectives:

a. General objectives

The general objective was to evaluate financial analysis on the performance and position of Uchumi Supermarkets Ltd.

b. The specific objectives:

- To evaluate performance in relation to liquidity, gearing, profitability, growth and efficiency of asset utilization and identify areas of weaknesses and strength.
- To carry out the trend analysis in relation to the above areas of performance.
- To compare financial performance of Uchumi over a period of time

1.6 Research questions

- What is Uchumi's financial performance in relation to liquidity, gearing, profitability, and growth and efficiency ratios?
- What is Uchumi's position in relation to financial performance?
- What is financial trend analysis for uchumi supermarket between 2000 and 2004?

1.7 Research hypothesis.

- The financial analysis has no relationship with the performance and position of a firm.

1.8 Scope of the study

The research has been restricted to Uchumi supermarket Limited situated in Nairobi town. It was concentrated in the finance and accounts department of the company, the data collection took four weeks, the response from the field has been used in data analysis. The findings have then been presented using charts, graphs and tables.

1.9 Significance of the study

To the organization

- The findings of this study are of significant benefit to the management Uchumi Supermarket Limited. As this research will identify and point out critical issues related to financial analysis as a basis for establishing the performance of a firm and its position.

To other users

- The findings of this study provide a starting block for policy makers in different organizations in reviewing their financial analysis options.
- This study provides investors with information on how the company is performing and the financial position so that they can make decisions on whether to sell or buy the shares and also the value of a share.
- The findings are important for comparative analysis purposes, to academicians and future researchers who will be undertaking researches related to this subject and in similar institutions
- Customers are able to know how the business is performing and its financial position so that they can assess whether they can rely on the firm for future supplies.
- Lenders and Suppliers are able to assess whether the business would be able to pay up the amounts due.
- Managers are able to determine whether the business is operating as per the plans. In case the plans are not achieved then the managers will come up with appropriate measures (controls) to ensure that the set plans are met.

- The Employees are able to know how the company is performing so as to make decisions on their terms of employment. This information would be important as they can use it to negotiate for better terms including salaries, training and other benefits. They can also use it to assess whether the firm is financially sound and therefore to some extent whether their jobs are secure.

Other users include the government, the public and financial analysts (IFRSs, 2005).

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews existing literature on financial analysis and more specifically on the ratio analysis as a tool to establish the performance of a firm; Uchumi supermarket in Kenya

Management should be particularly interested in knowing financial strengths of the firm to make their best use and to be able to spot out financial weaknesses of the firm to take suitable corrective actions.

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 the firm or by parties outside the firm like owners, creditors, investors and others.

Financial analysis is the conversion of financial data into useful information for decision making. Therefore, virtually any use of financial statements or other financial data for some purpose is financial analysis and, essentially, is the primary focus of accounting and finance professionals. Financial analysis can be internal (e.g., decision analysis by a company using internal data to understand or improve management and operating results) or external (e.g., comprehensive analysis for such purposes as commercial lending or investment activities). The key is how to analysis available data to make correct decisions.

2.1 Financial statements

Financial statements provide information of value to company officials as well as to various outsiders, such as investors and lenders of funds. Publicly owned companies are required to periodically publish general-purpose financial statements that include a balance sheet, an income statement, and a statement of cash flows.

Some companies also issue a statement of stockholders equity and a statement of comprehensive income, which provide additional detail on changes in the equity section of the balance sheet.

Financial statements issued for external distribution are prepared according to generally accepted accounting principles (GAAP), which are the guidelines for the content and format of the statements. In the United States, the Securities and Exchange Commission (SEC) has the legal responsibility for establishing the content of financial statements, but it generally defers to an independent body, the Financial Accounting Standards Board (FASB), to determine and promote accepted principles.

2.1.0 Balance sheet

The balance sheet, also known as the statement of financial position or condition, presents the assets, liabilities, and owners' equity of the company at a specific point in time. The assets are the firm's resources, financial or non financial, such as cash, receivables, inventories, properties, and equipment. The total assets equal (balance) the sources of funding for those resources: liabilities (external borrowings) and equity (owners' contributions and earnings from firm operations).

Investors, creditors, and other decision makers to assess the overall composition of resources, the constriction of external obligations, and the firm's flexibility and ability to change to meet new requirements use the balance sheet.

Firms frequently issue a separate statement of stockholders' equity to present certain changes in equity, rather than showing them on the face of the balance sheet. The statement of stockholders' equity itemizes the changes in equity over the period covered, including investments by owners and other capital contributions, earnings for the period, and distributions to owners of earnings (dividends) or other capital. Sometimes companies present a statement of changes in retained earnings rather than a statement of stockholders' equity. The statement of changes in retained earnings, also known as the statement of earned surplus, details only the changes in earned capital: the net income and the dividends for the period. Then the changes in contributed capital (stock issued, stock options, etc.) must be detailed on the balance sheet or in the notes to the financial statements.

2.1.1 Income statements

The income statement, also known as the statement of profit and loss, the earnings statement, or the operations statement, presents the details of the earnings achieved for the period. The income statement separately itemizes revenues and expenses, which result from the company's ongoing major or central operations, and the gains and losses arising from incidental or peripheral transactions. Certain irregular items (such as discontinued operations, extraordinary items, effects of accounting changes) are presented separately, net of tax effect, at the end of the statement. When revenues and gains exceed expenses and losses, net income is realized. Net income for the period increases equity. The results of the firm's operating activities for the period

as presented in the income statement provide information that can be used to predict the amount, timing, and uncertainty of future cash flows. This statement is useful to investors, creditors, and other users in determining the profit ability of operations. The income statement must also show earnings per share (EPS), where the net income is divided by the weighted average number of shares of common stock outstanding. Since EPS scales income by the magnitude of the investment, it allows investors to compare diverse companies of different sizes; hence, investors commonly use it as a summary measurement of firm performance.

In 1998, the FASB required that companies present a separate statement that classifies all items of other comprehensive income by their nature. Other comprehensive income includes all equity changes not recorded in the income statement or in the statement of changes in retained earnings and that do not result from contributions by owners. In addition to providing a separate statement, companies must display the total of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet.

2.1.2 Cash flow statements

The statement of cash flows replaced the statement of changes in financial position in 1987 as a required financial statement for all business enterprises. The statement of cash flows presents cash receipts and payments classified by whether they stem from operating, investing, or financing activities and provides definitions of each category. Information about key investing and financing activities not resulting in cash receipts or payments in the period must be provided separately. The cash from operating activities reported on the statement of cash flows must be reconciled to net income for the period. Because GAAP requires accrual accounting methods in preparing financial statements, there may be a significant difference between net income and

cash generated by operations. The cash-flow statement is used by creditors and investors to determine whether cash will be available to meet debt and dividend payments.

2.1.3 Notes to the account

Financial statements include notes, which are considered an integral part of the statements. The notes contain required disclosures of additional data, assumptions and methodologies employed, and other information deemed useful to users.

The financial statements of publicly owned companies also include an auditor's report, indicating that the statements have been audited by independent auditors. The auditor's opinion is related to fair presentation in conformity with GAAP.

The external financial statements required for not-for-profit organizations are similar to those for business enterprises, except that there is no ownership component (equity) and no income. Not-for-profit organizations present a statement of financial position, a statement of activities, and a statement of cash flows. The financial statements must classify the organization's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. Each of three classes of net assets permanently restricted, temporarily restricted, and unrestricted must be displayed in the statement of financial position, and the amounts of change in each of those classes of net assets must be displayed in the statement of activities. Governmental bodies, which are guided by the Governmental Accounting Standards Board (GASB), present general-purpose external financial statements that are similar to those of other not-for-profit organizations, but they classify their financial statements according to fund entities.

2.2 Ratio 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". The relationship between two accounting figures expressed mathematically is known as 'financial ratio'. Ratios help to summarize large quantities of financial data and to make qualitative judgment about the firm's financial performance. It measures the firm's liquidity, profitability. For instance, the greater the ratio the greater the firm's liquidity and vice-versa. The point to note is that a ratio reflecting a quantitative relationship helps to form a qualitative judgment

The standards of comparison of ratio analysis involve comparison for a useful interpretation of the financial statements. A single ratio is itself does not indicate favorable or unfavorable condition. It should be compared with some standard. It consists of:

PAST RATIOS: Ratios calculated from past financial statements of the same firm.

COMPETITORS RATIOS: Ratios of some selected firms, especially most progressive and successful competitor, at the same point of time.

INDUSTRY RATIOS: Ratios of industry to which the firm belongs.

PROJECTED RATIOS: Ratios developed using the projected or proforma, financial statements of the same firm.

Ratio Analysis is a form of Financial Statement Analysis that is used to obtain a quick indication of a firm's financial performance in several key areas. The ratios are categorized as Short-term

Solvency Ratios, Debt Management Ratios, Asset Management Ratios, Profitability Ratios, and Market Value Ratios.

Ratio Analysis as a tool possesses several important features. The data, which are provided by financial statements, are readily available. The computation of ratios facilitates the comparison of firms which differ in size. Ratios can be used to compare a firm's financial performance with industry averages. In addition, ratios can be used in a form of trend analysis to identify areas where performance has improved or deteriorated over time.

Because Ratio Analysis is based upon accounting information, its effectiveness is limited by the distortions which arise in financial statements due to such things as Historical Cost Accounting and inflation. Therefore, Ratio Analysis should only be used as a first step in financial analysis, to obtain a quick indication of a firm's performance and to identify areas which need to be investigated further.

The pages below present the most widely used ratios in each of the categories given above. One should keep in mind that there is not universal agreement as to how many of these ratios should be calculated. You may find that different books use slightly different formulas for the computation of many ratios. Therefore, if you are comparing a ratio that you calculated with a published ratio or an industry average, make sure that you use the same formula as used in the calculation of the published ratio.

2.3 Classification of Ratios:

The 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 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. They are classified into 4 categories:

Liquidity ratios, Leverage ratios, Activity ratios, Profitability ratios

2.3.1 LIQUIDITY RATIOS:

Liquidity ratios measure the firm's ability to meet current obligations. It is extremely essential for a firm to be able to meet its obligations as they become due liquidity ratio's measure. The ability of the firm to meet its current obligations, in fact analysis is of liquidity needs in the preparation of cash budgets and cash and funds 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 the company to meet its obligations due to the lack of sufficient liquidity will result in poor credit worthiness, loss of creditors' confidence or even in legal tangles resulting in the closure of company. A very high degree of liquidity is also bad, idle assets earn nothing. The firm's funds will be unnecessarily tied up to current assets. Therefore, it is necessary to strike a proper balance between high liquidity and lack of liquidity. Current ratio, Quick ratio, Interval measure, Net working capital ratio

Current ratio

Current assets include cash and those assets which can be converted into cash with in a year, such as marketable securities, debtors and inventories. Current liabilities include creditors, bills

payable, accrued expenses, short-term bank loan, income tax liability and long term debt maturing in current year. The current ratio is a measure of firm's short-term solvency.

As a conventional rule a current ratio of 2:1 or more is considered satisfactory. The current ratio represents margin of safety for creditors

$$\text{CURRENT RATIO} = \text{CURRENTS ASSETS} / \text{CURRENT LIABILITIES}$$

Quick ratio

Quick ratio establishes a relationship between quick or liquid, assets and current liabilities. Cash is the most liquid asset, other assets which are considered to be relatively liquid and included in quick assets are debtors and bills receivables and marketable securities. Therefore, we subtract inventories from total current assets, since they are the least liquid among the current assets

Generally a quick ratio of 1:1 is considered to represent a satisfactory current financial condition

$$\text{QUICK RATIO} = \frac{\text{CURRENT ASSETS - INVENTORIES}}{\text{CURRENT LIABILITIES}}$$

Interval measure

The ratio which assesses a firm's ability to meet its regular cash expenses is the interval measure. Interval measure relates the liquid assets to average daily operating cash outflows.

The daily operating expenses will be equal to cost of goods sold plus selling, administrative and general expenses less depreciation divided by number of days in the year.

$$\text{INTERNAL MEASURE} = \frac{\text{CURRENT ASSETS - INVENTORIES}}{\text{AVERAGE DAILY OPERATING EXPENSES}}$$

Net working capital ratio

The difference between current assets and current liabilities excluding short term bank borrowing is called net working capital or net current assets. Net working capital is some times used as measure of firm's liquidity.

$$\text{NET WORKING CAPITAL RATIO} = \frac{\text{NET WORKING CAPITAL}}{\text{NET ASSETS}}$$

2.3.2 LEVERAGE RATIOS:

The short term creditors, like bankers and suppliers of raw material are more concerned with the firm's current debt paying ability. On the other hand, long term creditors like debenture holders, financial institutions etc. are more concerned with firms long term financial strength. In fact a firm should have short as well as long term financial position. To judge the long-term financial position of the firm, financial leverage or capital structure, ratios are calculated. These ratios indicate mix of funds provided by owners and lenders. As a general rule, there should be an appropriate mix of debt and owners equity in financing the firm's assets.

Debt Ratio, Debt Equity Ratio, Capital employed to net worth ratio; Other Debt Ratios

$$\text{DEBT RATIO} = \frac{\text{TOTAL DEBT}}{\text{NET ASSET}}$$

Debt Equity ratio

It is computed by dividing long term borrowed capital or total debt by Share holders fund or net worth.

$$\text{DEBT EQUITY RATIO} = \frac{\text{LONGTERM BORROWED CAPITAL}}{\text{SHAREHOLDERS FUND}}$$

Capital employed to Net worth ratio

There is another alternative way of expressing the basic relationship between debt and equity. It helps in knowing, how much funds are being contributed together by lenders and owners for each rupee of owner's contribution. This can be found out by calculating the ratio of capital employed or net assets to net worth

$$\text{CAPITAL EMPLOYED TO NETWORTH RATIO} = \frac{\text{CAPITAL EMPLOYED}}{\text{NETWORTH}}$$

2.3.3 ACTIVITY RATIOS:

Funds of creditors and owners are invested in various assets to generate sales and profits. The better the management of assets, the larger is an amount of sales. Activity ratios are employed to evaluate the efficiency with which the firm manages and utilizes its assets these ratios are also called turnover ratios because they indicate the speed with which assets are being converted or turned over into sales. Activity ratios, involve a relationship between sales and assets. Inventory turnover ratio, Debtors turnover ratio, Collection period, Net assets turnover ratio, Working Capital turnover ratio

Inventory Turnover ratio

Inventory turnover ratio indicates the efficiency of the firm in producing and selling its product. It is calculated by dividing cost of goods sold by average inventory. Average inventory consists of opening stock plus closing stock divided by 2.

$$\text{INVENTORY TURNOVER RATIO} = \frac{\text{COST OF GOODS SOLD}}{\text{AVERAGE INVENTORY}}$$

Net profit ratio

Net profit is obtained when operating expenses, interest and taxes are subtracted from the gross profit. The net profit margin is measured by dividing profit after tax or net profit by sales.

$$\text{NET PROFIT RATIO} = \frac{\text{NET PROFIT}}{\text{SALES}}$$

Operating expense ratio

Operating expense ratio explains the changes in the profit margin ratio.

$$\text{OPERATING EXPENSES RATIOS} = \frac{\text{OPERATING EXPENSES}}{\text{SALES}}$$

The higher operating expenses ratio is unfavourable since it will leave operating income to meet interest dividends etc.

Return on investment

The conventional approach of calculating return on investment is to divide profit after tax by investment. Investment represents pool of funds supplied by shareholders and lenders. While PAT represent residue income of shareholders

$$\text{RETURN ON INVESTMENT} = \frac{\text{PROFIT AFTER TAX}}{\text{INVESTMENT}}$$

Return on equity

Ordinary shareholders are entitled to the residual profits. A return on shareholders equity is calculated to see the profitability of owner's investment. Return on equity indicates how well the

firm has used the resources of owners. The earning of a satisfactory return is the most desirable objective of business.

RETURN ON EQUITY = PROFIT AFTER TAX

NETWORTH

Earnings per share

The measure is to calculate the earning per share. EPS simply shows the profitability of the firm on a per share basis, it does not reflect how much is paid as dividend and how much is retained in business.

EARNINGS PER SHARE = PROFIT AFTER TAX

NO. OF SHARES OUTSTANDING

Dividends per share

The net profits after taxes belong to shareholders. But the income which they really receive is the amount of earnings distributed as cash dividends. Therefore, a larger number of present and potential investors may be interested in DPS rather than EPS. DPS is the earnings distributed to ordinary shareholders divided by the number of ordinary shares outstanding.

DPS = EARNINGS PAID TO SHAREHOLDERS

NO. OF SHARES OUTSTANG

Dividend payout ratio

The dividend pay out ratio is simply the dividend per share divided by Earnings per Share.

DIVIDEND PAID OUT RATIO = DIVIDEND PER SHARES

EARNINGS PER SHARES

Price earning ratio

The reciprocal of the earnings yield is called price earning ratio. The price earning ratio is widely used by security analysts to value the firm's performance as expected by investors. Price earning ratio reflects investors' expectations about the growth of firm's earnings. Industries differ in their growth prospects.

$$\text{PRICE EARNINGS RATIO} = \frac{\text{MARKET VALUE PER SHARE}}{\text{EARNINGS PER SHARE}}$$

2.4 Financial analysts often assess the firm's:

1. **Profitability**- its ability to earn income and sustain growth in both short-term and long-term. A company's degree of profitability is usually based on the income statement, which reports on the company's results of operations;
2. **Solvency**- its ability to pay its obligation to creditors and other third parties in the long-term;
3. **Liquidity**- its ability to maintain positive cash flow, while satisfying immediate obligations;

Both 2 and 3 are based on the company's balance sheet, which indicates the financial condition of a business as of a given point in time.

4. **Stability**- the firm's ability to remain in business in the long run, without having to sustain significant losses in the conduct of its business. Assessing a company's stability requires the use of the income statement and the balance sheet, as well as other financial and non-financial indicators.

Using the following;

Past ratios: Ratios calculated from past financial statements of the same firm.

Competitor ratios: Ratios of some selected firms, especially most progressive and successful competitor, at the same point of time.

Industry ratios: Ratio of industry to which a firm belongs.

Projected ratios: Ratios developed using the projected financial statements of the same firm

2.4 Analysis of Ratios

A. Analyzing Liquidity

Liquid assets are those that can be converted into cash quickly. The short-term liquidity ratios show the firm's ability to meet its short-term obligations. Thus a higher ratio would indicate a greater liquidity and lower risk for short-term lenders. The Rules of Thumb for acceptable values are: Current Ratio (2:1), Quick Ratio (1:1).

While high liquidity means that the company will not default on its short-term obligations, one should keep in mind that by retaining assets as cash, valuable investment opportunities may be lost. Obviously, cash by itself does not generate any return. Only if it is invested will we get future return.

B. Analyzing Debt

Debt ratios show the extent to which a firm is relying on debt to finance its investments and operations, and how well it can manage the debt obligation, i.e. repayment of principal and periodic interest. If the company is unable to pay its debt, it will be forced into bankruptcy. On

the positive side, use of debt is beneficial as it provides tax benefits to the firm, and allows it to exploit business opportunities and grow.

Note that total debt includes short-term debt (bank advances + the current portion of long-term debt) and long-term debt (bonds, leases, notes payable).

1. Leverage Ratios

a. Debt to Equity Ratio. This shows the firm's degree of leverage, or its reliance on external debt for financing.

b. Debt to Assets Ratio. Some analysts prefer to use this ratio, which also shows the company's reliance on external sources for financing its assets.

In general, with either of the above ratios, the lower the ratio, the more conservative (and probably safer) the company is. However, if a company is not using debt, it may be foregoing investment and growth opportunities. This is a question that can be answered only by further company and industry research.

A frequently cited rule of thumb for manufacturing and other non-financial industries is that companies not finance more than 50% of their capital through external debt.

Net cash flow = Net Income +/- non-cash items (e.g. -equity income + minority interest in earnings of subsidiary + deferred income taxes + depreciation + depletion + amortization expenses)

D. Analyzing Efficiency

These ratios reflect how well the firm's assets are being managed.

The inventory ratios show how fast the inventory is being produced and sold.

1. **Inventory Turnover** = Cost of Goods Sold / Average Inventory

This ratio shows how quickly the inventory is being turned over (or sold) to generate sales. A higher ratio implies the firm is more efficient in managing inventories by minimizing the investment in inventories. Thus a ratio of 12 would mean that the inventory turns over 12 times, or the average inventory is sold in a month.

2. **Total Assets Turnover** = Sales / Average Total Assets

This ratio shows how much sales the firm is generating for every dollar of investment in assets. The higher the ratio, the better the firm is performing.

3. **Accounts Receivable Turnover** = Annual Credit Sales / Average Receivables

4. **Average Collection period** = Average Accounts Receivable / (Total Sales / 365)

Ratios #3 and #4 show the firm's efficiency in collecting cash from its credit sales. While a low ratio is good, it could also mean that the firm is being very strict in its credit policy, which may not attract customers.

5. Days in Inventory = Days in a year / Inventory turnover

Ratio #5 is referred to as the “shelf-life” i.e. how quickly the manufactured product is sold off the shelf. Thus #5 and #1 are related.

E. Value Ratios

Value ratios show the “embedded value” in stocks, and are used by investors as a screening device before making investments.

For example, a high P/E ratio may be regarded by some as being a sign of “over pricing”. When the markets are bullish (optimistic) or if investor sentiment is optimistic about a particular stock, the P/E ratio will tend to be high. For example, in the late 1990s Internet stocks tended to have extremely high P/E ratios, despite their lack of profits, reflecting investors' optimism about the future prospects of these companies. .

A low P/E ratio may show that the company has a poor track record. On the other hand, it may simply be priced too low based on its potential earnings. Further investigation is required to determine whether the company would then provide a good investment opportunity.

2.5 Summary

Ratio analysis plays an important role in the corporate world. It is a widely used tool of financial analysis. Ratio Analysis is relevant in assessing the performance of a firm in respect of liquidity position, long-term solvency, operating efficiency, overall profitability, inter-firm comparison and trend analysis.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter focuses on, research design, data collection and analysis to be used to arrange the information in such a way that will enable the researcher to come up with the reliable recommendations and conclusions.

3.1 Design and location of the study

The research designs is the plan of research, it adapted hypothesis testing. Hypothesis testing was done in order to see if ratio analysis cannot be used to determine the company's performance and position. The researcher selected from various research designs after considering the type of and nature of the study, the source list, the sampling frame and designed standards of accuracy.

The importance generated by choosing ratio analysis as an appropriate tool for determining the performance and position of the firm greatly influences the area of study. Choosing the research area therefore was based on the importance and efficiency of using ratio analysis as a tool for financial analysis.

3.2 The study population

The study mainly focused on the management and staff of Uchumi supermarket Limited, Kenya. They were employees of the finance and accounting department and the top management decision makers of the company. They include the directors of operations directly involved in decision-making and subordinate staff of the organization working under the Finance and

Accounting department. This population was targeted since they are the people who are entrusted with financing decisions and financial analysis of the company of the company

The Uchumi supermarket in Nairobi was selected because of its convenience in accessibility, the limited financial resources available to the researcher and the researcher's familiarity to the organization.

The targeted population consisted of three employees of each of the six Uchumi supermarkets in Nairobi town. The primary respondents for this research included the Director Administration and Finance, operations Manager, and the subordinate staff working in the Finance and Accounting department.

3.3 Sampling design

A stratified random sampling technique was used in picking the employees on whom the data was to be collected. (This is where a population is first divided into subgroups (strata) and a sample is selected from each stratum.) Three staff members were selected from each of the stratum.

Simple random sampling technique was then used in selecting the employees to constitute the sample from each stratum. All the sampled employees were contacted personally to obtain answers. This sampling design was used because every element had a chance of being selected and it is more accurate than systematic random sampling and simple random sampling.

3.4 Types of data

The researcher used two types of data in the study; the primary data and the secondary data. The primary was obtained by the use of interviews and questionnaires. The secondary data involve

the analysis of various internal and external documents in order to obtain the information and other sources that are necessary for the production of the final report.

3.5 Data collection methods

Data collection is the process of gathering and measuring information on variables of interest, in an established systematic fashion that enables one to answer stated research questions, test hypotheses, and evaluate outcomes (Office of Research Integrity –ORI, Website).

Both primary and secondary methods were used. The primary methods included questionnaires and interviews of the respondents. While secondary data collection will involve documentation on financial analysis done by other researchers, Internet, Kenya stock market, financial books from the library.

3.5.1 Methods used

a. Questionnaire technique

Data was collected by the use of structured questionnaires designed by the researcher. The questionnaires were sent to the department heads and staff. This technique was used because all the respondents are literate. The major advantage of this method included; unbiased information and enough time for the respondent to consider his/her points carefully than in an interview.

b. Interviewing method

The personal interviews were carried out by the researcher as a follow up of the questionnaires so that the interviewee is aided in the areas of difficulty and seek an in depth discussion and explanation on matters missed on the questionnaires.

3.6 Analysis and interpretation

Once the data had been collected, the researcher analyzed it, both qualitatively and quantitatively. The analysis involved the establishment of the effectiveness of the use of ratio analysis in determining the firm's performance. The data obtained was analyzed under a stated research design so as to answer the questions with the collected data. It's from this analysis and observation that the researcher came up with a comprehensive conclusion and recommendations on the effectiveness of using ratio analysis in determining the performance and position of a firm.

3.7 Limitations of the study

The researcher was faced with limitations in the process of this research;

- Obtaining or accessing financial information was not easy for the researcher, as this area is a very sensitive issue in most organizations.
- Some of the respondents were unwilling to answer the questionnaires thus leading to the delay in data collection.
- There was the problem of information access by the researcher from the management of the company

CHAPTER FOUR

DISCUSSIONS, DATA ANALYSIS AND INTERPRETATION

4.0 DISCUSSIONS

Data was classified between primary and secondary data. Secondary data was preferable in this case because it may solve problem situations without having to use primary data and thereby saving on time and costs (BPP, 2004).

The main source of data was the company's (Uchumi Supermarkets Ltd) published financial statements from the years ended 30 June 2000 to 30 June 2004 and the Nairobi Stock Exchange Handbook for year 2002.

The company's published financial statements include not only the final accounts but also some insight into the factors contributing to the overall financial performance and position of the company. The final accounts have been used to compute the ratios while the additional information has been considered in the analysis of the ratios and the financial statements.

Questionnaires were sent to the field to source information to achieve the objective of evaluating the financial position and performance of Uchumi Supermarket. The response was good and three quarters of the questionnaires were dully answered and returned.

Distribution of Questionnaires

The responses from the respondents were encouraging as a total of nineteen (19) questionnaires out twenty five (25) distributed were duly filled and returned. The following table shows the responses received from different departments. This then represented an overall response rate of 76%.

Table 1 Response:

Departments	Issued questionnaire	Returned questionnaires	Percentage of Responses
Operations	5	3	60%
Finance	7	5	71%
Accounting	10	8	80%
Administrative	3	3	100%
Total	25	19	76%

Source: Author 2008

4.1 DATA ANALYSIS AND PRESENTATION

Data analysis is the process of systematically applying statistical and logical techniques to describe, summarize, and compare data (Center for Disease Control and Prevention –CDC, website).

Data analysis also involves studying the content so as to discover the meaningful components and define their patterns, rules, and attributes to build a structure for the content for future use (Vasont, website).

For the purpose of assessing the financial situation of Uchumi Supermarket Ltd, the analysis of ratios together with the given financial statements may be a good starting point.

The analyzed data has been presented by use of narratives, charts, graphs or tables. The use of charts and graphs gives a visual perspective and quick understanding of the summary outcome of the data analyzed.

4.2 Preparation of financial statements of uchumi.

The researcher found out that the accountants are responsible for the preparation of Uchumi's financial statement of they present to the chief accountant. The financial statements are presented to the Shareholders by the financial manager.

4.3 Department charged with Financial statement Analysis

Financial Analysis in Uchumi supermarket is carried out by the Accounting department, which is presented quarterly as required by the company Act. Ratio analysis based on the company's financial statements is used to carryout financial analysis.

4.4 Relevance of Ratio Analysis

Uses

Ratios are very useful in not only comparing the financial performance and position of a firm over a period of time, firm with other firms in the same industry. Comparison over time is referred to as trend analysis while comparison with other firms in the same industry is cross sectional analysis is normally evaluated: The profitability of the firm, The liquidity position, The Leverage or gearing position, The market value, The efficiency in use of its assets.

To set standards against which future results can be compared and any significant variances can be analyzed and acted upon.

Ratios are used to carry out forecasting and assist in the budgeting process.

To evaluate performance, compared to previous years and to competitors and the industry

Limitations

Even though ratios are widely used in financial statement analysis, there are certain limitations inherent that analyst should be aware. These include:

Ratios are based on historical financial statements, which reflect the events that have taken place in the past. They are not an accurate indicator for forecasting.

Different firms use different accounting policies, practices and assumptions; this makes comparison between firms using ratios difficult.

Ratios are also meaningless by themselves, as they have to be used together with other data. (Pandey, 1999).

There is considerable *subjectivity* involved, as there is no “correct” number for the various ratios. Further, it is hard to reach a definite conclusion when some of the ratios are favorable and some are unfavorable.

Ratios are based on financial statements that reflect the past and not the future. Unless the ratios are stable, it may be difficult to make reasonable projections about future trends. Furthermore, financial statements such as the balance sheet indicate the picture at “one point” in time, and thus may not be representative of longer periods.

Financial statements provide an assessment of the costs and not value. For example depreciation, this may not reflect the actual current market value of those assets.

Financial statements do not include all items. For example, it is hard to put a value on human capital (such as management expertise). And recent accounting scandals have brought light to the extent of financing that may occur off the balance sheet

4.5 Uchumi's financial performance in relation to liquidity, gearing, profitability, and growth and efficiency ratios.

To evaluate performance in relation to liquidity, gearing, profitability, growth and efficiency of asset utilization and identify areas of weaknesses and strength, ratios were classified as below:

Ratios can be classified into the following five main categories: Liquidity, Leverage/Gearing ratios, Activity Ratios, Profitability, Equity / Investor ratios.

The computation of each ratio is shown was presented as below;

4.5.1 Liquidity ratios

Liquidity ratios measure the firm's ability to meet its short term maturing obligations of liabilities. However the current assets should not be unreasonably high as this can lead to a situation of over capitalization.

$$1. \text{ Current ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

On average a ratio of 2:1 is acceptable. For Uchumi supermarket Ltd the current ratio for each of the years is given as follows:

Table 2

Year	2000	2001	2002	2003	2004
Ratio	1.17:1	0.73:1	0.72:1	0.58:1	0.52:1

Source: Accounting department

4.5.2 Graphical presentation of trend analysis of Uchumi's financial performance and position

2. Quick ratio /acid test ratio.

$$\frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$$

This is a more refined ratio that tries to recognize the fact that stocks may not be easily converted into cash. A ratio of 1:1 is acceptable. The quick ratio for Uchumi is given as follows:

Table 3

Year	2000	2001	2002	2003	2004
Ratio	0.43:1	0.21:1	0.19:1	0.11:1	0.17:1

Source: Accounting Department

3. Cash ratio

$$\frac{\text{Cash} + \text{Marketable Securities}}{\text{Current Liabilities}}$$

This ratio assumes that stocks may not be converted into cash easily and the debtors may also not pay up their accounts immediately. The cash ratio for the company is given as follows:

Table 4

Year	2000	2001	2002	2003	2004
Ratio	0.35:1	0.09:1	0.07:1	0.04:1	0.03:1

Source: Accounting Department

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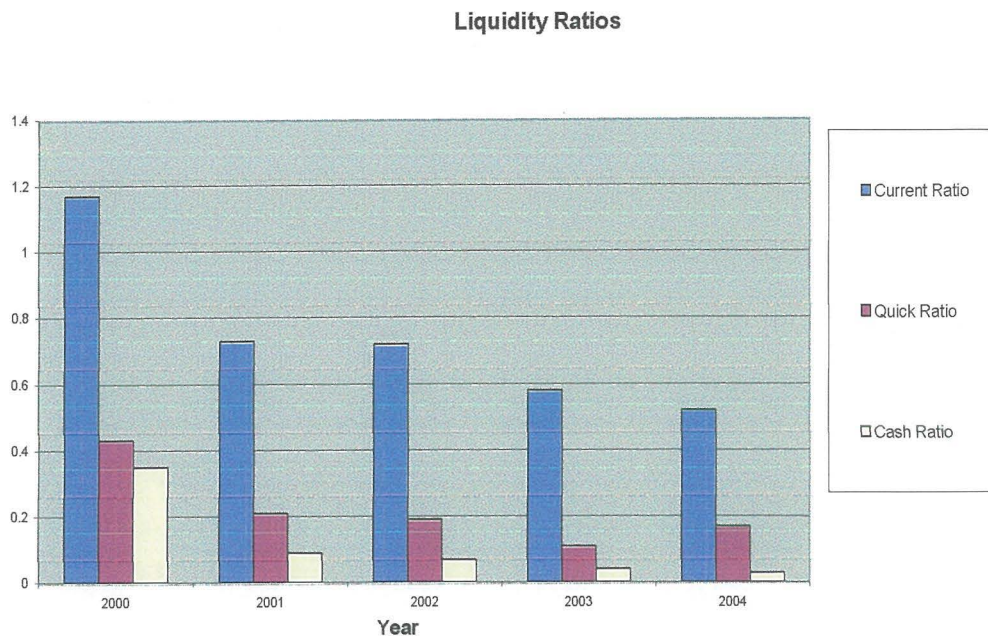
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Table 4

Year	2000	2001	2002	2003	2004
Ratio	0.35:1	0.09:1	0.07:1	0.04:1	0.03:1

Source: Accounting Department

Graph 1



From the computations given, it appears that the liquidity position is very poor as the highest level reached for current ratio has been 1.17:1 in year 2000 as compared to the ideal ratio of 2:1. Unfortunately the situation gets even worse as the years go by and in 2004 the ratio is standing at 0.52:1. A similar trend is noted for quick ratio and cash ratio.

The problem as indicated by the balance sheets over the same period shows that the firm has more current liabilities than current assets commencing from year 2001. This is as a result of the firm selling goods for cash, while getting supplies on credit. The cash flow statement also shows the firm was financing most of its property, plant and equipment intangible using cash received from operations. This means that the firm is not paying its creditors but instead using the cash to finance expansion. The expansion was largely setting up new branches.

A summary of the three ratios can be presented as follows graphically to reflect the trend:

4.5.3 Gearing ratios

These ratios measure the extent to which non-owners have financed the firm.

They measure the financial risk of a firm (the probability that a firm will not be able to pay up its debts). The more debts the firm has, the higher the financial risk. Examples include:

1. Debt ratio

$$= \frac{\text{Total Liabilities} \times 100}{\text{Total Assets}}$$

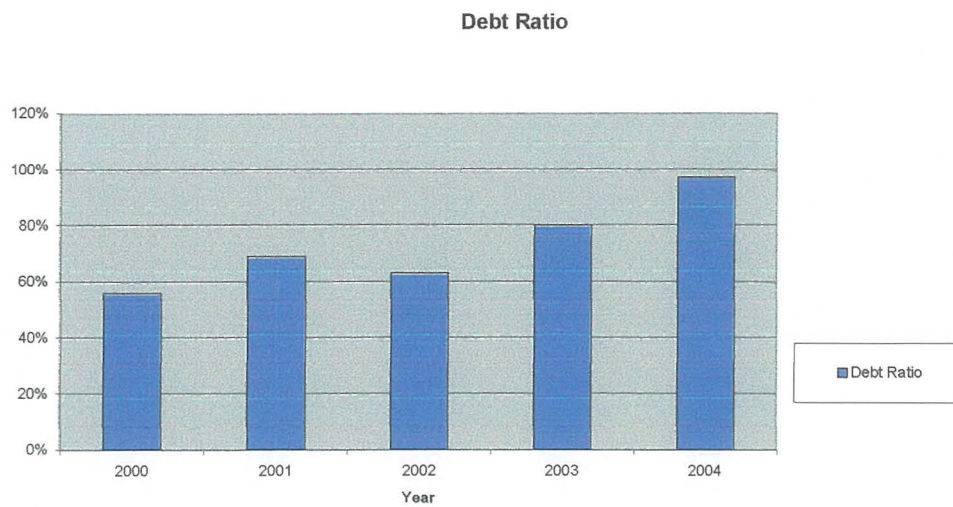
This ratio measures the proportion of total assets financed by non-owner supplied funds. The debt ratio for Uchumi Supermarket is given as follows:

Table 5

Year	2000	2001	2002	2003	2004
Ratio	56%	69%	63%	80%	97%

Source: Accounting Department

Graph 2



1. Debt equity ratio.

$$= \frac{\text{Total Liabilities}}{\text{Equity}}$$

This ratio measures how much has been financed by the non-owner supplied funds for every shilling invested in the business by the owners.

The debt equity ratio of Uchumi Supermarket is given as follows:

Table 6

Year	2000	2001	2002	2003	2004
Ratio	1.26:1	1.31:1	1.73:1	3.90:1	28.69:1

Source: Accounting Department

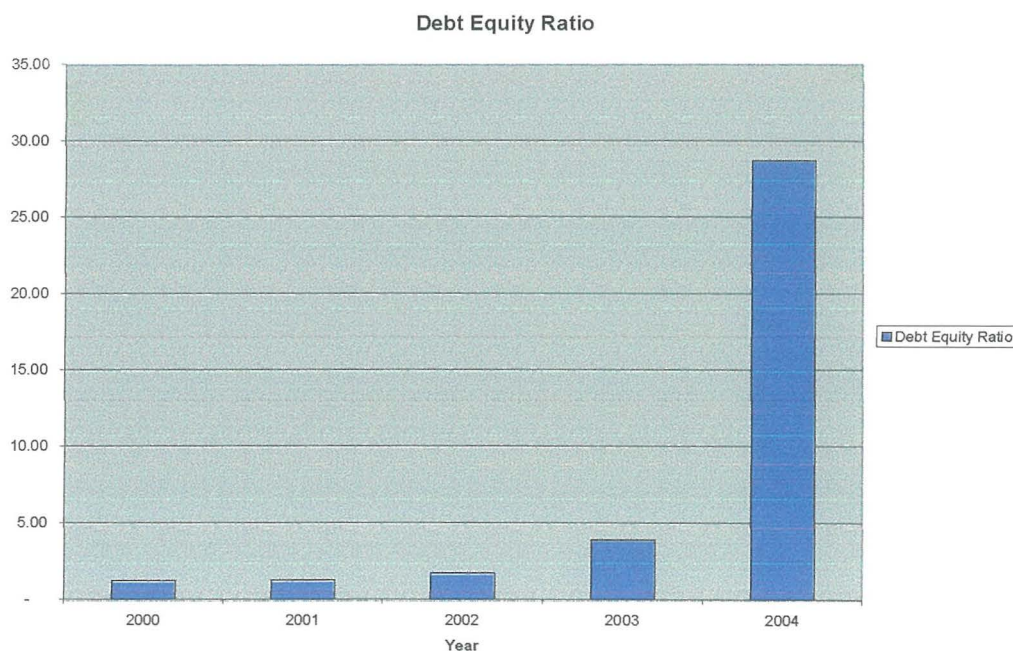
The firm is highly geared as indicated by the gearing ratios and the level of gearing increases over the period under consideration.

The debt ratio shows that 56% of the assets are financed by liabilities in year 2000 and this figure increases to 97% by year 2004. A similar trend is also shown by the Debt equity ratio that indicates for every contribution by shareholders, the creditors have contributed 1.26 times in year 2000 and 28.69 times by year 2004.

This is due to the fact that the company is not able to pay its creditors and the liquidity position is very poor. Therefore the financial risk of the company is very high i.e. the chances of paying the creditors and other lenders are very low.

A graphical presentation of the ratios is as follows:

Graph 3



4.5.4 Activity Ratios

Activity ratios measure the efficiency with which the firm manages and utilizes its assets (Pandey, 1999). The ratios evaluate the use of assets to generate revenue and management of debtors and creditors.

Examples include:

1. Stock Turnover

$$\text{Stock Turnover} = \frac{\text{Cost of Sales}}{\text{Average Stocks}}$$

This is the number of times stock has been converted to sales in a financial year. The higher the ratio the more active the firm is. The stock Turnover ratio for the company is given as follows:

Table 7

Year	2000	2001	2002	2003	2004
Ratio	6.83 times	9.51 times	7.69 times	5.90 times	7.24 times

Source: Accounting Department

2. Debtors' collection period

These ratios measure the number of days it takes for debtors to pay up. The shorter the period, the better for the firm as it improves the liquidity position and ensures that a lot of cash is not tied in debtors but is available for running the business.

3. Non current Assets or (Fixed Assets) Turnover

$$= \frac{\text{Sales}}{\text{Average Fixed Assets}}$$

Average Fixed Assets

The ratio measures the efficiency with which the firm is using its fixed/ Non Current Assets to generate sales. The higher the ratio the more active the firm is. The ratio for the company is as follows:

Table 8

Year	2000	2001	2002	2003	2004
Ratio	9.8 times	8.29 times	5.77 times	4.78 times	4.3 times

Source: Accounting Department

4. Total assets turnover

$$= \frac{\text{Sales}}{\text{Total Assets}}$$

Total Assets

The ratio measures the efficiency with which the firm is using its total assets to generate sales.

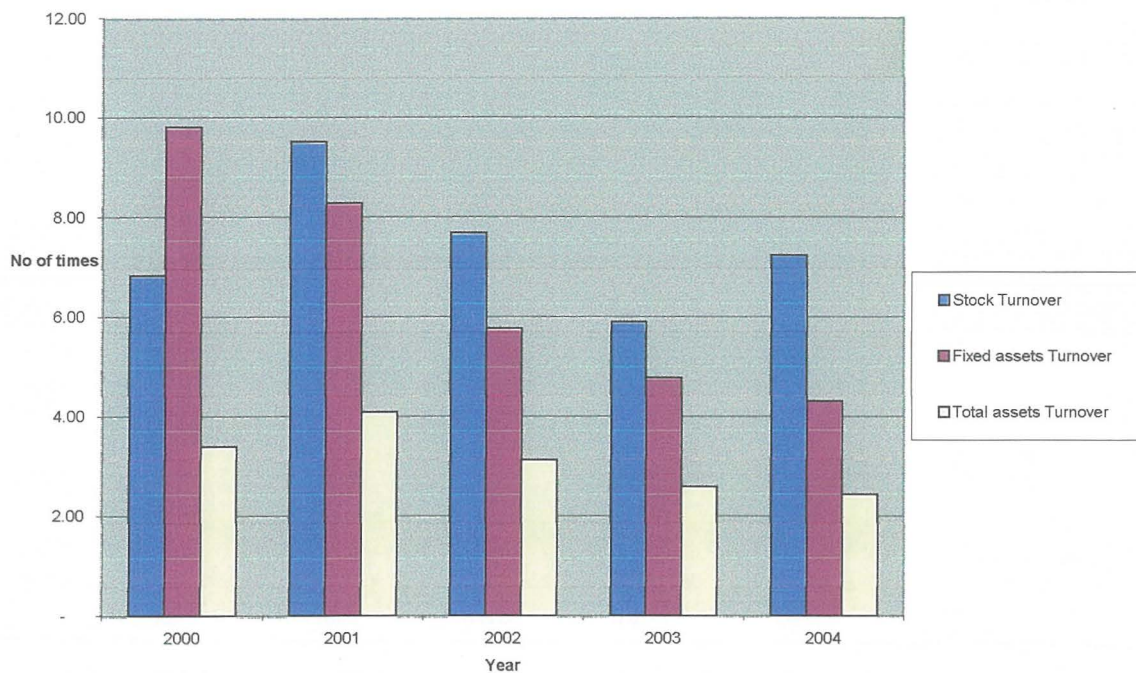
The Total assets turnover for the company is as follows:

Table 9

Year	2000	2001	2002	2003	2004
Ratio	3.39 times	4.08 times	3.12 times	2.59 times	2.44 times

Source: Accounting department

Graph 4 **Activity ratios**



The ratios especially stock turnover, show that Uchumi supermarket is less efficient in utilizing its assets to generate sales. The level of efficiency has declined over time as indicated by the fixed assets and total assets turnover ratios. This can be explained by the fact that the firm has increased the level of its assets, especially fixed assets, where as revenue has remained stable over time (see appendix 1). The number of times revenue is generated in a year from using fixed assets has declined from 9.8 in year 2000 to 4.3 times in year 2004.

The number of times stock is sold each year has fluctuated between a high of 9.51 times in year 2001 and a low of 5.9 times in year 2003. This means that it takes between 38 and 62 days before inventory is sold. This is an indication of low efficiency in the use of inventory.

The activity ratios can be presented as follows graphically:

4.5.5 Profitability ratios

These measure the efficiency with which the firm is using its various funds to generate profits or returns. They also measure the management's ability to control the various expenses in the firm.

The higher the ratios, the more profitable the firm is.

a) Profitability in relation to Sales

1. Gross Profit margin

$$= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

The profitability ratio for the company is given as follows:

Table 10

Year	2000	2001	2002	2003	2004
Ratio	16.83%	15.4%	17.31%	16.27%	14.42%

Source: Accounting Department

2. Net profit margin

$$= \frac{\text{Net Profit after tax}}{\text{Sales}} \times 100$$

This margin is affected by operating expenses for the period. Profit before tax may be a suitable alternative as it is not affected by underlying tax issues. (BPP, 2004)

The net profit margin for the company is given as follows:

Table 11

Year	2000	2001	2002	2003	2004
Ratio	3.9%	1.1%	0.6%	-2.2%	-8.7%

Source: Accounting Department

b) Profitability in Relation to investment

1. Return on investment (ROI)

$$= \frac{\text{Net Profit after tax} \times 100}{\text{Total Assets}}$$

This shows how efficient the firm has used the total assets to generate returns in the business.

The return on investment for the company is given as follows:

Table 12

Year	2000	2001	2002	2003	2004
Ratio	13.27%	4.58%	1.96%	-5.72%	-21.41%

Source: Accounting Department

2. Return on Capital employed.(ROCE)

$$= \frac{\text{Net Profit before interest and tax}}{\text{Net Assets (Shareholders funds + non-current liabilities)}}$$

It indicates how efficient the firm has been in using the net assets to generate returns in the business. The return on capital employed for the company is given as follows:

Table 13

Year	2000	2001	2002	2003	2004
Ratio	38.34%	-115.65%	9.02%	-23.92%	-119.65%

Source: Accounting Department

3. Return on equity (ROE)

$$= \frac{\text{Earnings after tax}}{\text{Net worth}}$$

Net worth

Return on equity measures the efficiency with which the firm is using the owner's capital to generate returns. The return on equity is give as follows:

Table 14

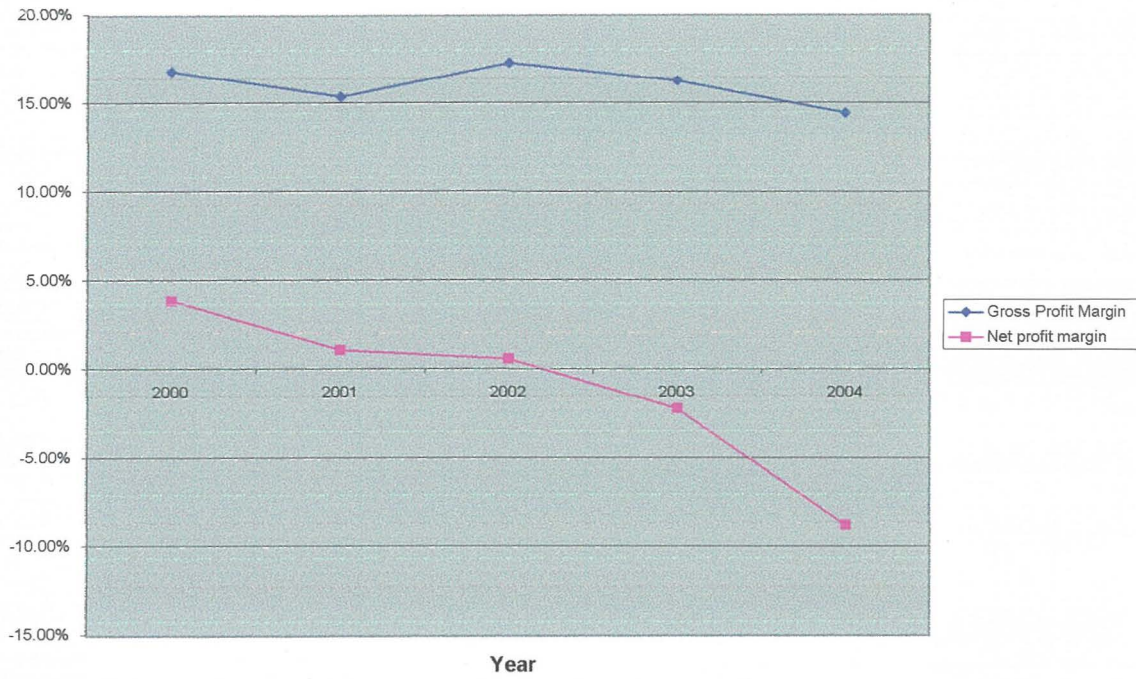
Year	2000	2001	2002	2003	2004
Ratio	29.96%	8.7%	5.35%	-28%	-635.57%

Source: Accounting Department

The ratios can be presented as follows graphically:

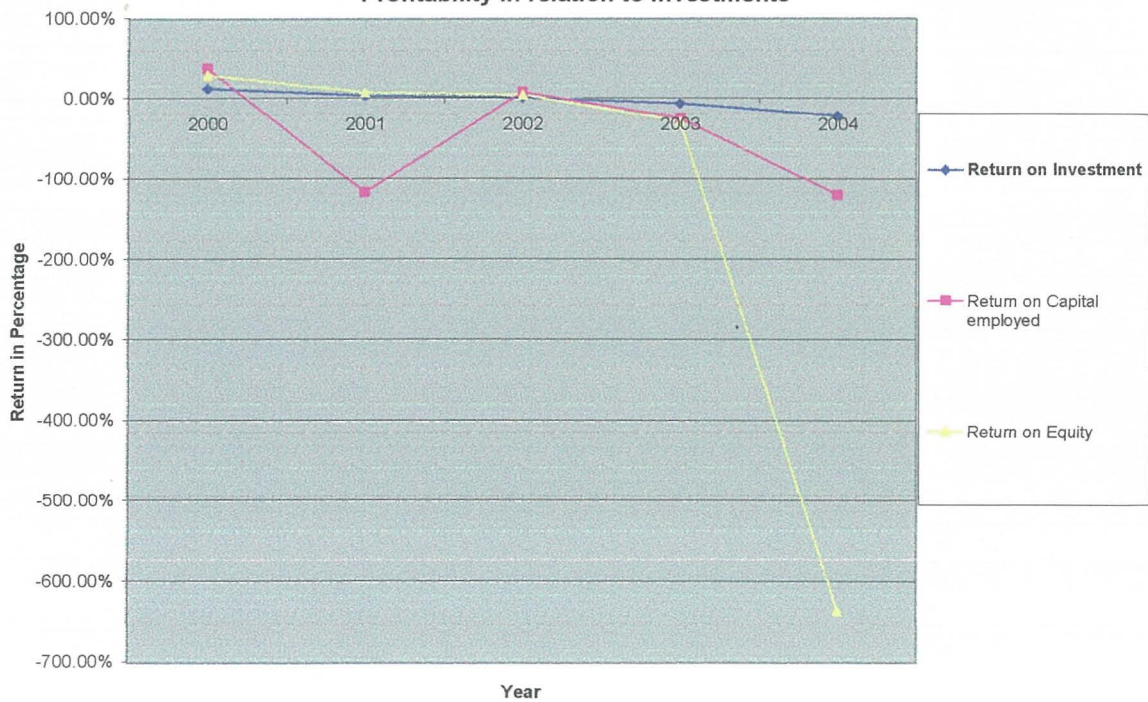
Graph 5

Net & Gross Profit Margins



Graph 6

Profitability in relation to Investments



Uchumi supermarket limited has performed poorly over the period under consideration due to its declining profitability. The gross profit margin even though has remained stable, is very low to support the operating expenses and financing costs of the firm. An average of 16% over the five year period is very low. However this could be a strategy aimed at shutting out competitors.

The net profit margin has reduced significantly from 3.9% in 2000 to (8.7%) in 2004, which is a 323%, decrease! This is explained by the fact that operating costs increased at a very high rate but Turnover and gross profit remained stable over the same period. Operating expenses are about sh.926 million in year 2000 and slightly over shs 2 billion in year 2004, an increase of about 116%. The income statement shows the reduction in profits from sh.283 million to sh.50 million in year 2000 and year 2002 respectively. The profits declined to a loss of about sh.700 million in year 2004.

This gives an indication that the firm is not able to control its operating expenses although some expenses like depreciation and amortization may be traced to the newly acquired fixed assets due to expansion.

The reduced profitability is also highlighted by the returns on resources and various funds that the firm has. The return on total assets, capital employed and shareholders funds have all registered a declining trend over the period. For instance the return on total assets reduced from 13.27% in year 2000 to (21.41%) in 2004.

4.5.6 Equity/Investor ratios

They measure the relative value of the firm and returns expected by the owners of the firm. They also indicate the overall performance of the firm.

1. Earnings Per share (EPS)

$$\text{EPS} = \frac{\text{Earnings attributable to ordinary shareholders}}{\text{Number of ordinary shares outstanding.}}$$

Number of ordinary shares outstanding.

This is the return expected by an investor for every share held in the firm. The Earnings Per share of the company is given as follows:

Table 15

Year	2000	2001	2002	2003	2004
Ratio	4.71	1.49	0.83	-3.28	-11.65

Source: Finance Department

2. Earnings Yield

$$= \frac{\text{Earnings per Share}}{\text{Market price per share}} \times 100$$

This is the amount expected by a shareholder for every shilling invested in the business. The earnings yield for the company is given as follows:

Table 16

Year	2000	2001	2002	2003	2004
Ratio	11.02%	3.27%	5.19%	-10.25%	-66.57%

Source: Finance Department

The earnings yield is based on the market price per share as at 30 June of each year, which is given as follows:

Table 17

Year	2000	2001	2002	2003	2004
Market price (Kshs.)	42.75	45.50	16	32	17.50

Source: Finance Department

3. Dividend Per share (DPS)

$$= \frac{\text{Total Ordinary Dividend}}{\text{Number of ordinary shares outstanding.}}$$

Number of ordinary shares outstanding.

This is the amount expected by an investor for every share held in the firm.

The dividend per share for the company is given as follows:

Table 18

Year	2000	2001	2002	2003	2004
Ratio Kshs.	2.3	1	0.5	0	0

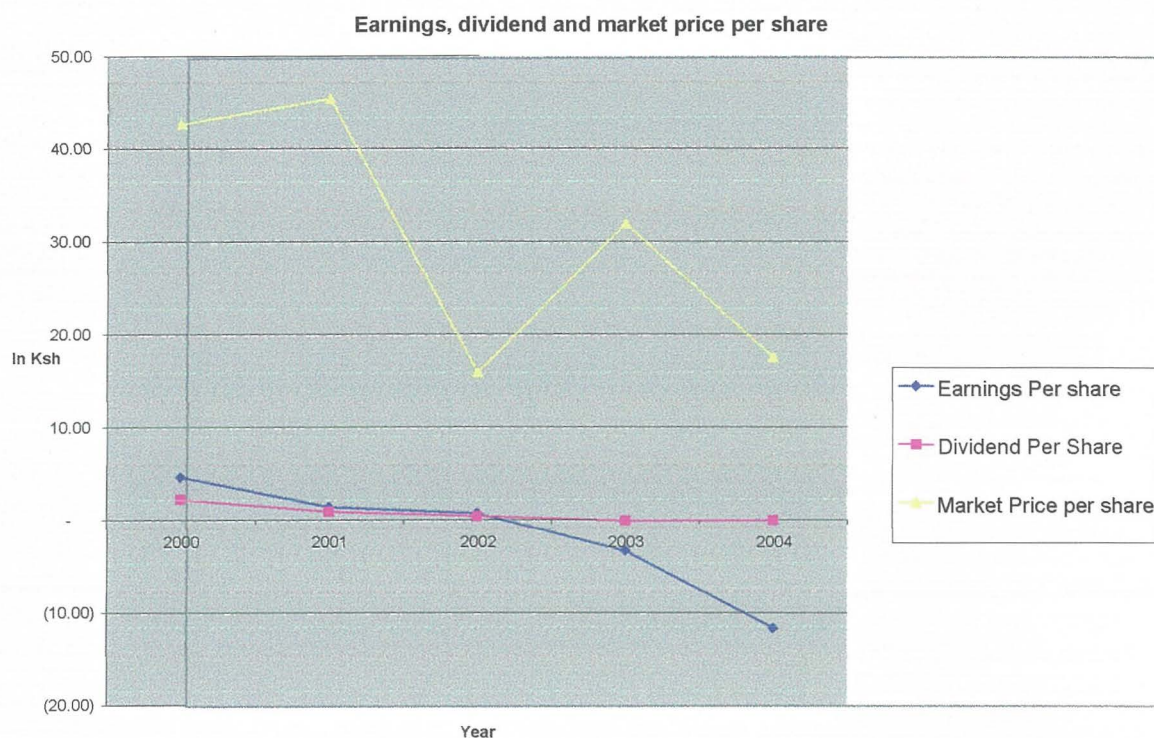
Source: Finance Department

Investor ratios indicate the value the existing shareholders and potential investors place on the firm. It may be difficult to justify the behavior of some of the ratios because the value of a firm depends on many factors apart from the financial information.

In the case of Uchumi Supermarkets Ltd, The earnings per share, earnings yield and dividend per share ratios have really declined but the market price does not follow a similar pattern of the three ratios. The earnings per share have reduced from Kshs. 4.71 in 2000 to Kshs. (11.65) in 2004 while the dividend per share has reduced from Kshs. 2.3 in 2000 to 0 in 2004. This is expected because the firm cannot pay dividends with the trend in reduced profitability.

The earnings per share, dividend per share and market price per share can be summarized as follows graphically:

Graph 7



The market price has also registered a downward trend because of the declining profitability. The reduction is about 60% from Kshs. 42.75 in 2000 to Kshs. 17.5 in 2004. Surprisingly, in year 2003 the market price went up to Kshs. 32 from Kshs. 16 in year 2002.

In summary, the value of the firm according to investors is low and this is attributable to the fact that an investor expects to loose rather than gain upon investment in the shares of the company. Trading in the shares of the company may still go on as some investors try to sell the shares to minimize the possible future losses while others may buy at the low prices hoping that the company will become profitable in the future and therefore sell the shares at a profit.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter focuses on the discussions, conclusions and the recommendations based on the findings from the previous chapters. The main objective was to evaluate the relationship of financial analysis and the performance and position of a firm.

5.1. Discussions

Uchumi's financial position

The analysis, done by the use of computed ratios and the financial statements indicate a company that is heading for collapse unless the management carries out strategies to turn around the company.

The liquidity position is low and creditors cannot be paid especially when the amounts are due. This has resulted in very high gearing position and hence the increase in financial risk. It will be difficult for the company to borrow funds to finance not only the long-term assets but also the operating activities.

The profitability is declining and in fact, the company is now making losses. The loss making situation has also had a slight impact on the firms ability to avail goods to customers and recent press reports has indicated that the company is losing customers to competitors.

The researcher found that financial analysis has a significant relationship with the performance and position of a firm.

Over the period under study, ratio analysis followed its own pattern independent of the other as shown in the table and graphs. For profitability, gearing, liquidity, activity, the figures fluctuated from one financial year to another revealing a down pattern through the period under review. Year 2000/2004 where there was a sharp decrement.

In the case of ratios and financial statement, the researcher found out that it play a big role when it comes to analysis of the firm financial position and performance. This because the figures indicated when interpreted reveals the strengths and weakness of the firm.

It was further noted that the higher the ratio as financial analysis instrument, couldn't be depended on its own. This limits the decision-making using ratios in regard to performance of the firm.

The accounting and finance department continues to face some problems on what best techniques to be used for the financial analysis, that will show the true financial position and performance of a firm. Some of the problems that were pointed out were that the company is not so willing to give out information from finance and accounts department as their competitors might use this to outdo them. This has limited the researcher with enough information for analysis. The findings proved that ratio analysis alone cannot be used for financial analysis but financial statements like balance sheet, income statement, cash flows and notes to the account are of importance. This is because ratios are derived from the financial statements.

From the results of data analysis it is clear that there is a significant relationship between the ratio analysis and position and performance of the firm. The analysis of different ratios as a above indicated a decline in performance from 2000-2004 (trend analysis). This threatened the financial position of Uchumi supermarket, which finally led to its collapsed in 2004.

5.2 Conclusion

Use of ratios is a very important tool of financial analysis. From the ratios and financial statements of Uchumi Supermarkets, the company is not a good investment. Profitability is down; a high financial risk and poor efficiency in using its assets indicate that it will not be wise for prospective investors to buy shares in the company.

Further more, the ratios highlight the areas of weaknesses that the management and directors needs to address like declining liquidity and determine alternative modes of turning round the company. These factors that led to the collapse of Uchumi were the major reasons for this research.

In addition to the use of ratios in analyzing the financial position of the company, we can also use the Z – Score to predict whether the company will go into bankruptcy. The Z - Score model has proven to be a reliable tool for bankruptcy forecasting in a wide variety of contexts and markets. It has been applied to test firms in different sectors, private or public, manufacturing or non manufacturing and others.

The formula for the **Z score** for a public non-manufacturing firm like uchumi Supermarket is given as follows: (The CPA journal online, Feb 1995)

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4$$

Where X_1 = Working Capital/Total Assets.

Where X_2 = Retained Earnings/Total Assets.

Where $X3 = \text{Earnings before Income \& Taxes} / \text{Total Assets}$.

Where $X4 = \text{Market Value of Equity} / \text{Book Value of Debt}$.

To assess the likelihood of bankruptcy, the company's Z - score is compared with the predetermined cutoffs shown below.

Bankrupt	less than	1.1
Zone of ignorance		1.1-2.6
Non bankrupt	greater than	2.6

The Z score for the company is given as follows (see appendix 3):

Table 19

Year	2000	2001	2002	2003	2004
Vale	2.53	(0.18)	0.72	1.15	(0.66)

On average the Z score has had a declining trend towards the zone of bankruptcy. The firm appeared good in year 2000 but from year 2001, it has been on the bankruptcy zone. The model appears to be reliable because in year 2004, press reports had actually indicated the firm as collapsing.

However Z score model cannot be used in isolation and therefore it will be important to consider other qualitative aspects of the firm and measures being taken by the firm so that the firm may

really not end up in bankruptcy. Furthermore the Z score model may not apply in all situations as each company may have a unique situation. The same case applies for ratios that have inherent limitations.

5.3 Recommendations

International Accounting Standard (IAS) should come up with a standardize financial analysis technique to assess the position and performance of the firm.

Accounting and finance Department of Uchumi should include Z – score to predict whether the company will go into bankruptcy

Companies through investment analysis should decide on a good investment with high Profitability, low financial risk and good efficiency in using its assets.

Investors to buy shares in the company should check on the firm's liquidity, profitability, with low gearing ratio, activity ratios and finally to consider high investors' ratios.

Financial analyst should consider other instruments for financial analysis, as the use of ratios alone cannot stand on the own to make decisions.

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APPENDIX 1

Questionnaire

My name is Sylvia Akinyi Osaka, a student of Kampala International University. I'm an Undergraduate in the school of Business and Management undertaking Bachelor in Business and Management (Accounting option)

It is my humble request to the respondents that you may answer this questionnaire with maximum honesty. It is meant for academic purpose and all the information will be held confidential by the researcher

Instruction: i) Tick the correct answer from the choices given, for objective questions.

ii) For essays, write precise and clear answers

1 a) Who is charged with the preparation of financial statements of uchumi?

Internal Auditors ☐ Accountants ☐ Financial analyst ☐

b) Who are they answerable to?

Shareholders ☐ Chief accountant ☐ Financial Manager ☐

2. a) Which department is charged with the responsibility of performing financial analysis?

.....
.....

b) Who are they answerable to?

Accounting and finance department ☐ Shareholders ☐ Directors ☐

3. How often does Uchumi carryout financial analysis?

Monthly ☐ Quarterly ☐ Semi annually ☐ Annually ☐

4. How does Uchumi evaluate its financial performance? Through:

Ratio analysis ☐ Financial statement analysis ☐ Share price ☐

5. What has been Uchumi's trend analysis on financial performance since 2000-2004?

Ratios

year	liquidity	Profitability	Leverage	Activity
2004				
2005				
2006				
2007				

6. a) How is uchumi performing financially?

Poor ☐ Fair ☐ Good ☐ Excellent ☐

b) How does performance stated above affect your long-term strategies?

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7. How does ratio affect capital budgeting of Uchumi?

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8. What are the importance of using ratio analysis by Uchumi?

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9. What are some of the limitation of using Ratio analysis by Uchumi?

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APPENDIX 2

TIME PLAN:

ACTIVITY	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY
feasibility study	***	***						
Proposal writing			***	***				
submission of the proposal						*****		
Data collection				***	***	***	***	
Data analysis							*****	***
Moderating of research project								***
Submission of final report								***
Literature review	***	***	***	***	***	***	***	***

APPENDIX 3

BUDGET

Item	Amount (KSH)
Transport	1000
photocopying	2500
Binding	2000
Stationery	1500
Secretarial services	1500
Total	8000