# FINANCIAL RATIOS AS EVALUATORS OF BUSINESS

# PERFORMANCE: A STUDY OF PEUGEOT AUTOMOBILE NIGERIA LIMITED (PAN)

**BY**

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**OCTOBER 1995**

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*Submitted in partial fulfillment of the requirements for the award of the Degree of Masters in Business Administration (MBA) ABU, Zaria.*

# ***DECLARATION***

This project is in partial fulfillment for the award of master of Business Administration (MBA) degree of Ahmadu Bello University (ABU) Zaria. I declare confidently without fear or reservation that this is a product of my brain supported by materials got from other sources, which are indicated by way of references. I accept liability for any error found in this write up and hope I will be pardon for this.

***BEN OBAMO SOJE (MR)***

# ***DEDICATION***

This Project is dedicated to my wife - Grace and my children - Tani, Biyedi, Tobora, and Moboni Iya.

DIGITIZED

## CERTIFICATION

This Thesis titled Financial Ratios as Evaluators of Business Performance: A Study of Peugeot Automobile Nigeria Limited (PAN) by Ben Obamo Soje, meets the regulations governing the award of the degree of Master of Business Administration (MBA) of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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# ACKNOWLEDGEMENT

As the saying goes, necessary encouragement and unalloyed support at all levels of human endeavor are invaluable contributions to the means of achieving a desired goal. I am happy that I was not denied such necessary support and encouragement from these groups of persons:

Firstly, Mallam M. N. Maiturare. My most sincere appreciation to a wonderful teacher and supervisor, whose advice, most inspiring directives, "open door policy", keen interest and profound love for research in this area, saw me through this study.

I am greatly indebted to Mohammadu Sodangi, who aroused my interest in Finance and particularly Financial Ratios.

I thank my friends and colleagues, Mallam Kabir, Rev. Opegbemi, M. M. Kwage, and Gwani for their moral support.

My special thanks are reserved for my wife and children for their support and encouragement.

I thank Rolex Computers Limited for typing the initial manuscript and Miss Laraba Bonet for the final work.

# ABSTRACT

Evaluation of the performance of a business is important to both Management and Investors if the business must guide against human and material distress. Since performance is an indication of how efficiently resources are being utilized, it is pertinent to note that the import of its evaluation must be carefully and rigorously studied.

This project is thus aimed at studying, interpreting and evaluating the performance Of Peugeot Automobile Nigeria Limited, a multi-National company jointly owned by Nigerian (60%) and Automobile Peugeot of France (40%) using twenty (20) Financial Ratios as a tool of Financial Analysis.

The study revealed that out of the Financial ratios adopted for Peugeot Automobile Nigeria Limited, Three ratios gave possible reasons for the various problem of the company, ranging from (inflation, stringent credit squeeze, inefficient use of fixed assets, slow moving incentives, under trading and operating losses), while others ratios indicated various problems and their effect on various aspects of the company's productivity levels. Six of the twenty ratios namely; Fixed asset turnover, Sales to working capital, Gross profit margin, Net profit margin, Stock Turnover, Interest cover ratios are good evaluators of the company's performance. While others indicated various problems and their effect on various aspects of the company's productivity levels.

The result of the Multiple Discriminant Analysis of the Altman Model also indicated financial difficulties. Among this are; excessive fixed assets, slow-moving incentives, hyper-cost push inflation, stringent credit squeeze etc.

Important recommendations were made for the improvement and management of the company business risk. The resulting ratios will assist the company's creditors and investors to identify and quantify risks, as well as quantifying the management's ability to handle such risks.

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*CHAPTER ONE*

# INTRODUCTION

## 1.1 GENERAL BACKGROUND

The analysis of financial statements, in order to judge the performance of a company or a group of companies, is based largely on Ratio Analysis. Financial Analysis is the process of identifying the firm's existing strengths and weaknesses. The strengths must be understood if they are to be recognized and corrective action taken. For example: are inventions adequate to support the projected level of Sales? Does the firm have too heavy an investment in Accounts Receivable, and does this condition reflect a Tax Collection Policy?

The analysis of financial statement is typically devoted to the calculation of Ratios in order to evaluate the past, current and projected performance of the business firm. Ratio Analysis is the most widely used technique for interpretation and comparison of financial reports. It is useful because it can be used to summarize relationships and results, which are significant to the appreciation of critical business indicators of performance. For example, the ratio of Net Profit is useful for the purpose of comparing performances from year to year, and the performances of different companies, given that aggregate figures are always of differing orders of magnitude.

The collection of ratios on a systematic basis allows trends to emerge, and throws into relief the significance of charges indicated by the analysis of current events.
The key to obtaining meaningful information from Ratio Analysis is comparison. Comparing ratios over time within the same business to establish whether performances are improving or declining, and comparing ratios between similar businesses to see whether the company being analysed is better or worse than average within its specific business sector

Standards of comparison may consist of:

1. Ratios calculated from the past financial statements of the same firm.
2. Ratios developed using the projected or proforma financial statements of the same firm.
3. Ratios of some selected firms, especially the most progressive and successful, at the same point in time.
4. Ratios of the industry to which the firm belongs.

## 1.2 STATEMENT OF THE PROBLEM

It is the responsibility of the management of any business organisation to see that resources are utilized efficiently and effectively, and that the firms' financial condition is sound and encouraging for the achievement of organisational objectives. Performance should be an indication of achievement in terms of good management of the organisation's resources.

The ability to predict performance is very important to any business in the private or public sector. Equally important is the ability to analyze past performance and project the trends into the future. Analysing business performance is useful and important to management, investors, creditors and individuals in order to take preventive measures against financial ruin, such as changing operating policy, and recognizing the financial structure in case of financial distress. The shareholders are interested in the present and future earnings, and the firm creditors are interested in how the firm uses its short-term loans to service its debts in the long run.

The balance sheet and profit and loss account alone do not give the full picture of the financial condition of the organisation. There most be a clear understanding, in the mind of the reader, of what lies behind the figures. Ratio analysis takes care of this, but it can be misleading if its limitations are ignored.

## 1.3 SIGNIFICANCE OF THE STUDY

It is the responsibility of the management of any business enterprise to see that resources are used efficiently and effectively and that the firm's financial condition is sound and encouraging. The ability to evaluate financial performance is very important to any business enterprise. Performance should be an indication of achievement in terms of good management of all resources available, both human and financial.

Evaluating business performance is useful and important to management, investors, individuals, etc., in order to take preventive measures against financial distress such as changing the operating policy and reorganizing the financial structure. Numerous ratios may be computed from financial reports and from other sources, notably stock exchange share prices. Only important ratios, which focus on two (2) critical areas, may be utilized. The critical areas are:

- The ability of the firm to survive and grow, and

- The efficiency of its financial performance

From the investor's viewpoint, maintenance and increase of the value of capital invested is the first consideration. The second consideration is the level of income, which he expects to derive from the invested capital. Clearly, both considerations are interrelated and interdependent.

The study would be of value to business people. Specifically, it would provide basic information to management, investors, customers, creditors, suppliers, debtors, students, and researchers on business performance and how to evaluate it.

Finally, it is our hope that this will add to the present stock of knowledge, and create avenues for future research.

## 1.4 PURPOSE OF THE STUDY

The purpose of this study is to use financial ratios in evaluating the business performance of PEUGEOT AUTOMOBILE NIGERIA LIMITED. The factors affecting or influencing performance are many and they vary from one industry to another. So it is very useful for management to identify the use of Financial Ratio Analysis as an evaluator of a firm's deficiencies such, as poor liquidity and low profitability. It is also helpful in predicting the future earnings performance and financial health of a company.

Among other things, the study examines:

1. How information generated by the Accounting System may be used to evaluate business performance.
2. How performance may be measured and evaluated, with a view to assist in the management of affairs.
3. The significance, as well as the problems in using accounting information for performance evaluation, and finally,
4. Identification of the methods of performance evaluation in Nigeria.

## 1.5 SCOPE OF THE STUDY

A number of ratios have strong evaluating power on business performance, but only twenty-six (26), ratios were considered. However, sixteen (16) of them were analyzed in this study. This limitation is so because many organizations in Nigeria are very secretive in their operations due to tax, tariff and other strategic reasons.

The ratios selected for the study are therefore intended to measure and evaluate the different aspects of business performance.

## 1.6 RATIOS USED IN THE STUDY

There are five (5) broad groups of financial ratios. These are: Liquidity, Profitability or Productivity, Activity, Debt, and Coverage ratios. Each of the groups has a number of financial ratios that might be computed, which increases geometrically with the volume of financial data. This study will concentrate only on the ratios needed to assess the financial conditions and the performance of the selected firm - Peugeot Automobile Nigeria Limited.

The ratios are as follows:

### (A) LIQUIDITY (Short - term Solvency) RATIOS:

1. Quick (Acid)
2. Current
3. Sales to Working Capital

### (B) LEVERAGE RATIOS (Long - term Solvency)

4. Debt - Equity (Earnings)
5. Debt - Capital Employed
6. Interest Cover Ratio

(C) **ACTIVITY (Efficiency) RATIO**

7. Average Collection Period - sales to total assets inventory turnover
8. Average Payment Period - sales to equity working capital to sales
9. Debtors Turnover - working capital to total assets
10. Stock Turnover - sales to fixed assets
11. Fixed Assets Turn Over - fixed assets to Network

(D) **PROFITABILITY RATIOS**

12. Return On Capital Employed (ROCE) - Primary ratio
13. Net Profit Margin
14. Gross Profit Margin
15. Operating Ratio

(E) **INVESTORS (Stock Exchange) RATIOS**

16. Earnings Per Share (EPS)
17. Price - Earnings (P/E) Ratio
18. Earnings Yield
19. Dividend Yield
20. Dividend Cover

## 1.7 ASSUMPTION OF THE STUDY

The study has assumed that the information in published financial statements of the company has been audited by qualified Auditing Firms and has been reviewed in detail by relevant government agencies. Consequently, the profits reported in these

published financial statements are reasonably reliable and they have been determined in accordance with generally accepted Accounting Principles and Standards as Specified by the Company and Allied Matters Decree (CAMD).

## 1.8 PRESENTATION OF THE PROJECT

The first chapter discussed the significance of financial ratios. It explained that financial ratios are the yardstick used to analyze the performance of any enterprise.

A review of some researches on the use of ratio analysis as a technique for investigating is presented in Chapter Two (2). Many Researchers like Altman and Beaver combined both models to assess the predictive ability of a large number of ratios.

The third chapter deals with the research methodology, which is concerned with procedures used in collection and classification of data.

The findings of the analysis or study based on the financial ratios are discussed in Chapter Four (4).

The last chapter, Chapter Five (5), contains recommendations and the conclusion.

The Appendix comprises of the computed values of Peugeot Automobile Nigeria Limit's ratios and graphical presentation of some ratios. This project ends with a Bibliography, which is arranged, in alphabetical order of names.

*CHAPTER TWO*

# LITERATURE REVIEW

Financial ratios do not have their roots in the country; however, many studies have demonstrated that financial ratios can be employed in evaluating the performance of an organization. Researches on financial ratios are not based on only one aspect of the firm but on many analyses of firm failure, bond rating, risk-determination and so on.

## 2.1 ACCOUNTING RATIO AND FINANCIAL ANALYSIS

A ratio is an index that relates two (2) sets of figures to one another. Ratio analysis can be described as a quantitative technique, which employs the ratios of several pairs of quantities generated by the firms to represent objectivity, outcomes of decisions made by the firms, and results of outside conditions surrounding the firms. "Financial Analysis" is essentially a subset of "Ratio Analysis". The objectives of the two are the same but the numbers of areas under scrutiny of financial analysis are increased as financial analysis may, in principle, concern itself with any and all aspects of the operations of the firm. Financial Ratio analysis, having originated in Accounting concerns itself, in practice, with ratios relating to balance sheet and income statement information. (Haskell; 1971:174).

An Accounting Ratio is said to be an expression of one set of financial data in terms of another in order to bring out the relationship between the two. It is obvious that the Absolute Accounting Figures reported in the financial statements do not provide a meaningful position, hence the risk inherent in a firm. They can only give meaning when they are related to some other relevant information. Accounting Ratios, therefore,

indicate a quantitative relationship, which can be used to make a qualification judgment. (Pandey; 1992:110).

Financial Analysis involves two (2) types of comparison: a comparison of present ratios with past and expected future ratios for the same firm, and a comparison of the ratios of one firm with those of similar firms or with the industrial average at the same point in time. The firs type is called "Trend Analysis" and the latter is called "Inter-Industrial Analysis" (Van Horne; 1990: 752-778).

### 2.1.1 **RATIO FORMATION AND INTERPRETATION**

Forming ratios requires that some logical relationship must exist between the items in the numerator and those of the denominator. In this respect, three kinds of logical relationships were suggested by Tamari (1966: 15-21):

(a) Ratios should relate matching components, that is, values that have economic relationship.

(b) Ratios should be formed only from elements based on common values, that is, similar valuation method should be used for both the numerator and the denominator, and

(c) Ratios should be formed only if the components are functionally related, that is, if they vary in some definite manner.

However, Williams (1991: 19-24), believes that these criteria are inadequate. He advanced the following argument against the criteria.

(a) That the requirement for an economically meaningful relationship between ratio components is self-evident.

(b) That the need for a common value-basis of ratio components is logically unsupported, and

(c) That the restriction of ratios to CO-variable items is inconsistent with the

Objective of financial analysis, since the relationship generally sought is not the one between the ratios and some economic indicator.

He therefore, concluded that ratios should be formed without restrictions, as long as it serves the purpose of the analyst.

Researchers have suggested various ratios interpretation methods on financial ratio analysis (Heffert; 1972: 22-25, Van Horne; 1990: 725-778 and Pandey; 1992: 145-149). These methods include:

(a) The classification of financial statements items into "good" and "bad" categories. The "good" includes assets, revenue, and capital, while the "bad" consists of liabilities and expenses. This classification is to provide a framework for ratio interpretation. Therefore, a high current ratio is desirable since it indicates an excess of "good" assets over "bad" liabilities.

(b) The use of the industrial average or the alternative measures of industrial average, also called the median. It is argued that observed ratios should be compared with industrial average and inference should be based on the extent and direction of deviation from the average.

(c) The use of absolute criteria has also been suggested. Well-known absolute criteria include the 2:1 value for the current ratio, the 1:1 minimum value for the Net worth to Fixed Asset and Net worth to Total Debt Ratios.

However, Williams (1991: 19-24) argued that the three methods of interpretation suggested above are not only inadequate, but also naive, often ambiguous, and usually unverifiable from an empirical point of view. Nevertheless, any of the three

methods may be used to interpret ratios since no better suggestion has been made. The determining factor should be the purpose for the analysis.

### 2.1.2 THE IMPORTANCE OF ACCOUNTING RATIO ANALYSIS

Ratio analysis is one of the most important tools of financial analysis (Pandey; 1992:110). Sincere groups of people are interested in analyzing the financial information to indicate the operating efficiency and various aspects of the firm's financial position. These groups are accounting ratios to determine the particular financial characteristics of the firm in which they are interested. With the help of ratios, we can determine:

(a) The ability of the firm to meet its current obligations,
(b) The extent to which the firm has meet its long-term obligations by borrowing funds,
(c) The efficiency with which the firm is utilizing its various assets in generating revenues, and
(d) The overall operating efficiency, performance and hence, risk involvement of the firm.

Accounting Ratio Analysis permits the charting of a firm's history and the evaluation of its present position. Such an analysis allows the Financial Manager to anticipate reactions of investors and creditors. This gives him good insight into how his attempts to acquire funds are likely to be received. The analysis of trends of the ratios also add considerable significance to the financial analysis because it studies the ratios of several years and isolates the exceptional instances occurring in one or two periods.

Accounting Ratio Analysis is also likely to give an analyst a clearer understanding of the financial conditions and performance of the firm than the traditional analysis of absolute financial data. The analyst can be a short-term creditor, who is interested the current financial position of the firm, or a long-term creditor interested in the solvency of the firm.

There are also equity shareholders, who are generally concerned with their returns and may bother about the firm's financial conditions only when their earnings are threatened.

Studies have also shown that accounting ratios have predictive power. Beaver (1968: 71-111), tested the ability of accounting ratios to predict failure. He discovered that accounting ratio analysis can help predict failure at least five years before it occurs. Altman (1968: 589) also used accounting ratios to predict corporate bankruptcy through the use of Multiple Discriminate Analysis (MDA). Similarly, George (1986: 65-105), established that appropriate ratios can be quite successfully employed to predict business failure before it actually occurs. Van Horne (1990: 769) went further to suggest that the best ratio for predictive purpose are the Debt-to-Net worth, the Net Operating Profit Margin, Debt Coverage and its stability, Return on Investment Size, and Earning Stability.

In Credit Analysis, the analyst will usually select a few important ratios. He may use the Current Ratio or Quick Ratio to judge the firm's liquidity or debt paying ability, Debt-equity Ratio to determine the state of the owner's interest in the long run, or any of the profitability ratios to determine the firm's earning prospects.

Finally, this type of analysis is also useful in Security Analysis. It can be used in the analysis of the investment merits of shares and bonds. When the emphasis is on Security Analysis, the principal focus is on judging the long-run profit potentials of the

firm. Profitability is, to a large extent, a measure of how efficiently a firm is run. Since Accounting Ratio Analysis provides an insight into this factor, it is useful to the security analyst (Edward; 1983: 589-600).

### 2.1.3 PROBLEMS OF RATIO ANALYSIS

Despite the usefulness of Accounting Ratios, it has to be used with caution due to inherent limitations. These limitations might lead to faulty decisions and interpretations. According to Pandey (1992: 153-154), and Morris (1983: 50), the following are the limitations and problems of ratio analysis:

(a) Ratios are based on historical financial accounts with all its shortcomings; therefore, they contain almost all the deficiencies of these accounts;

(b) Some ratios are open to manipulation and need to be interpreted with care e.g. stock levels may be kept artificially low towards the end of the accounting year to create an impression of high efficiency in this area, or long-term liabilities may be used to settle short-term liabilities towards the end of the accounting year to create a favorable liquidity position.

(c) Inter-firm comparisons are faced with the problem that different organizations might have used different accounting policies or that such firms operate under different constraints. Hence, comparison of ratio between different types of organizations can be misleading.

(d) There is a real danger that Ratio Analysis can lead to conclusions that are over-simplified. For example, a high Current Asset Ratio is seen as good, while a high Credit Period allowed to debtors is seen as bad. Very little attention is usually paid to determining optimal values for ratios.

(e) Detailed knowledge of a company's market and other operating environments is seldom obtainable from the financial accounts, yet such knowledge is particularly important for assessing future profitability.

(f) There are also problems relating to the comparison of an individual firm's own ratios over time. Changes in reported performance may be due to good or bad management or exceptional external factors.

(g) Ratios, taken in isolation, are almost useless. They have to be compared with something before they become meaningful.

## 2.2 DEFINITIONS OF SOME RATIOS

All ratios are important because no one ratio gives sufficient information about the performance and financial condition of any business. Although the number of financial ratios that may be computed depends on the amount of financial data available, this study will only concentrate on the important ratios.

The LIQUIDITY RATIO measures the firm's ability to meet its maturing short-term obligations and it has been proved to be the best in this area. It requires the use of cash budgeting.

The WORKING CAPITAL TO TOTAL ASSETS RATIO is frequently found in studies of business performance evaluations. Any firm should not allow its liquidity position fall below certain levels since it runs a high risk of failures due to technical insolvency.

PROFITABILITY RATIOS measure the effectiveness of management i.e. human and financial resources, which when fully managed, will generate returns on investments. More attention is on this ratio because the objective of any investment is to make profit. Without profit, business will not attract investors or outside capital.

**EARNINGS AFTER INTEREST AND TAXES TO TOTAL ASSETS RATIOS:** These particular ratios indicate how productive the firm has been in utilizing its facilities and resources to generate operating profits. It also indicates how firms can survive during problems like falls in their market share due to economic and political policies. The ultimate existence of the firm is based on the earning power of its assets. This ratio is appropriate for dealing with performance.

**NET WORTH TO TOTAL ASSETS RATIOS:** These indicate the value of the firm and the extent to which the owner is committed to the long-term survival and growth of the business.

**THE RETURN ON INVESTMENT (ROI):** This ratio measures the overall effectiveness of the management in generating profits with its available assets.

**EARNINGS PER SHARE:** It is the number of Naira earned on behalf of each outstanding share of common stock and it is very important to the management, as well as to the current, or prospective shareholder.

**ACTIVITY RATIOS:** Measure the performance of any business and also indicate how effectively the firm employs the resources at its command.

## 2.3 TYPES OF COMPARISONS:

There are two (2) basic ways in which financial ratios can be used:

(a) Time Series Analysis, and

(b) Cross Sectional Approach.

**TIME SERIES ANALYSIS:** It is the method used to measure a firm's performance over time. It compares the current performance with past performance using Ratio Analysis. It allows the firm to determine whether or not it is progressing as planned. Using multi-year comparison can see developing trends, and knowledge of these trends should assist the firms in planning future operations.

**CROSS-SECTIONAL APPROACH:** This approach involves the comparison of different firms' financial ratios at the same point in time. The comparison could be done with firms in the same industry. Such comparison is made to find out how well a firm has performed in relation to its competitors. Again, the firms' performance will be compared to that of the industry leader. Another type is to compare the firms' ratios to industry averages.

## 2.4 STUDIES ON USEFULNESS OF FINANCIAL RATIOS

Researches have been conducted in order to analyze the financial capabilities of business enterprises, which are aimed at providing tools for measuring the performance of business enterprises. Some of the researches will be discussed below:

Hickman (1958) studied the result of bonds issued during 1900-1943 and discovered that firms with high Times Interest Earned and Net Profit to Sales Ratios went into default less frequently than those with low ones and again discovered that the ratios are good default predictors whether studied jointly or separately.

SUALIER *et al* (1958) carried on a similar study in the United States of America and discovered that firms with very low Current Ratios and Net Worth to Total Debts Ratios were more likely to default on loans.

MOARE AND ALKANSON (1961) checked charges in bank credits and financial data and discovered that firms with higher Current Ratios and Working Capital to Total Assets, Net worth to Total Assets, and Net Profits to Net worth Ratios increased their use of credit more often than others.

A. M. WOJINLOWER (1962) investigated the quality of bank loans and analyzed critical loans for 1957 in three districts in the United States of America. He observed that 67% of firms with critical loans had Net worth to Total Debts Ratios below their various industry averages. Therefore, it could be said that firms with shaky Net worth to Total Debts Ratios may have problems with repayment of their loans.

HORRIGAN (1966) regressed rating as dependent variable against the financial ratios of some companies. He selected and developed a model - the multiple regression model- that consisted of Debt, Subordination, Sales to Net worth and Net Operating Income to Sales and attempted to predict the top six bond classifications for both Moody's standard and Poor's. He successfully predicted about fifty-eight percent (58%) of Moody's rating, and fifty two percent (52%) of standard and poor rating.

FALK AND HEINTZ (1975) attempted to rank industries according to the degree of risk based on particular industry characteristics as reflected in industry financial ratios. They analyzed forty-one industries (41) for the period 1971-1972 using five (5) ratios. They discovered they could group a significant number of industries based on degrees of risk as reflected in industry financial ratios.

financial ratios and on one hundred and thirty four (134) firms.

ORGLER (1970) developed a credit-scoring model for commercial bank loans using twenty-one (21) ratios selected from Valuation Ratio Categories and found he could predict criticized loans with some degree of success.

SMITH AND WINAKOR (1935) analyzed the trend of twenty-one (21) ratios for ten (10) years prior to failure. They observed that there was deterioration in the average value of failed firms and concluded that good indicators of approaching distress were Long-term Solvency Ratios. Also, Working Capital to Total Assets Ratios which declined from the beginning to the end of the period studied were observed to be the best indicators of approaching failure.

FITZ PATRICK (1931) analysed 3-5 year conditions of twenty (20) firms (that failed between 1920-1929) prior to failures by using thirteen (13) ratios for each of them respectively and compared his results with those of nineteen (19) non-failed firms. He then concluded that all ratios are capable of predicting failure to a certain extent.

PINCHES AND MINGO (1973) analysed 180 bonds for the whole of 1967, collected financial data on thirty-five (35) variables and developed a model that employed six variables using M-group Multiple Discriminate Analysis for factor analysis. The six variables contained in the model were: Subordination (legal status of the bond), Issue Size (that is bond ratings and the size of bond issue were related), Years of consecutive dividends (indicating ability to pay cash dividends), Net income to Total Assets, and Five Year Long-term Debt to Total Assets. Their model obtained 69.7% success of Moody's actual bond rating.

CHUDSON (1945) found that Short-term Liquidity and Long-term Solvency were the two factors that could be used to differentiate profitable from non-profitable firms when he classified firms as such.

MOYER (1977) sighted Altman's model on data for the period of 1965-1975 and found that its predictive ability dropped considerably. He found the predictive ability of the model to be increased when he excluded "super flows" variable from it. He also found the model to be a better failure predictor than other models when he compared them.

ALTMAN *et al* (1977) reviewed Altman's model and updated its application to 1969-1975. In doing this, fifty-three (53) failed and fifty-three (53) non-failed firms, including retailing firms were studied. Twenty seven (27) ratios were used in this study. Seven (7) were incorporated in a discriminate function which was found to predict correctly 96% and 70% failure respectively in the first and fifth year before bankruptcy.

COLLINS (1980) found that the Multivariate function of Altman was a better failure prediction than the Univariate Analysis made by Meyer and Pifer (1970), though he found that the two models provided good predictive results.

ABDELKHALIK AND EL-SHESHAI (1980) had samples consisting of sixteen (16) firms that had defaulted for non-debt payment and sixteen (16) non-defaultive firms representing twelve industries.

These firms were selected from the Index of Corporate Events in the "Issue of Disclosure" Journal (1973-1975). The main objective of these researches was to introduce a concept of sharing information with subjects or subordinates. In other words, they designed an experiment in Human Judgments. They also aimed, among other things, at improving the definition of environment designated as a failure.

According to them researches concerning failure prediction had followed two (2) approaches.

(a) Using Mathematical tools or statistical tools

(b) The use of accounting information in discriminating between failed and non- failed firms by human decision makers.

They made use of ten (10) financial ratios that had already been used in a previous Studies. Each of the trends was estimated by the average annual change in a financial item five years prior to default. They concluded among other things that judgment of reasonable quality could be made based on information from a few data items contained. They also found that the subject's choice of information was a barrier for predicting default on payment which was considered an environmental event by the authors.

## 2.5 RECENT CONTRIBUTIONS TO FINANCIAL RATIO ANALYSIS

Investment has become an important activity. A lot of contributions have been made in areas of financial ratio analysis to provide more accurate tools for assessing business performance. The most prominent of them are Univariate Analysis and Multivariate Analysis.

### 2.5.1 **UNIVARIATE ANALYSIS**

The approach is called Beta Analysis. The analysis examines the association between the relative risk measures of a security and a single accounting variable. Ball and Brown first published this analysis in 1969.

They analysed two hundred and sixty-nine (269) firms between the periods of 1946-1966. (Bearer and Mane gold (1975)). They studied two hundred and fifty-four (254) compustat firms over the period of 1951-1969. They adopted four steps in their analysis:

(a) They estimated the market for each firm on a monthly return basis all through the period.

(b) They estimated the accounting for each firm on annual earning basis over the period.

(c) They ranked the two hundred and fifty four (254) stocks on the basis of market, placing each stock in a portfolio between five and ten securities and calculated the average market and accounting for each portfolio.

(d) They estimated the correlation between the portfolio Security Market Betas and the Accounting Betas from (c) above.

In their analysis, the following financial variables were correlated with Security Market Betas:

1. Earnings Variability - (a)

2. Dividend-payment Ratio - (b)

3. Leverage - (c)

(a) Standard deviation of the earning to price ratio over the period

(b) Estimated firm's index model over the period

(c) Average Debt to Total Ratio over the period.

### 2.5.2 **MULTIVARIATE ANALYSIS**

It is an extension of Financial Ratio Analysis, which deals with the prediction of corporate bankruptcy. The most prominent is Edward I. Altman's (1968). He used the Multiple Discriminate Analysis (MDA) technique which was designed for Internal Control Considerations, that is, to predict a firm's financial problems so as to enable management, creditors, shareholders, employees and so on, take necessary action to prevent failure which will definitely affect them. He used the MDA to rank firms on the basis of a weighted combination of five (5) ratios. He identified twenty-two (22) ratios, although he selected only five (5) ratios and these ratios were used to calculate the Z.

He defined Z as the "overall index" or "Barometer" and finally arrived at the following:

$$A = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

Where:

$X_1$ = Working Capital to Total Assets

$X_2$ = Retained Earnings to Total Assets

$X_3$ = Earnings before Interest and Taxes to Total Assets

$X_4$ = Market Value of Equity to book Value of Total Debt

$X_5$ = Sales to Total Assets

He used Z values as follows:

1. If the Z value is greater than 2,99, the company is healthy
2. If the Z value is less than 1.81, then it is bankrupt. He later calculated the critical Z value. He got the critical Z to be 2.675 and concluded that any Z above 2.675 is a non-bankrupt firm and below or equal to 2.675 is bankrupt.

*CHAPTER THREE*

# RESEARCH METHODOLOGY

## 3.1 SAMPLE SIZE

The single firm selected as sample for the study is the leading car-assembly plant in the country. Another consideration was the availability of data for the years under study.

## 3.2 SAMPLE SELECTION

A single company was selected for this study. The company was studied for ten years (1984-1994). This period was selected for the following reasons:

1. The glut in the oil market with the prevalent economic recession persisted through out the period.

2. Under utilization of productive capacity within the period.

3. Fluctuation in turn over level/rate within the period.

4. The Structural Adjustment Programme (SAP) aimed at revamping the ailing national economy was introduced during this period.

5. It is within this period also that the Second-Tier-Securities Market (SSM) was established to give adequate recognition to the need to turn small and medium sized companies into big ones. These small and medium sized companies are owned and wholly promoted by indigenous entrepreneurs, foreign investors, and the Government.

The analysis of data collected and the result herein are considered to be a fair outlook of the study in general.

## 3.3 DATA COLLECTION

The search for relevant information for this study started with consulting the selected firm for their annual reports. The data needed was obtained from the annual reports and they were used for the calculation of the relevant ratios for the analysis.

*CHAPTER FOUR*

# FINANCIAL ANALYSIS OF THE SELECTED FIRM

## 4.1 OVERVIEW OF THE CHAPTER

This chapter is concerned with analyzing the financial ratios of the selected company. The investors, management, employees, and Government are interested in the financial positions and they have various reasons for their interest. With these varying interests, each of the ratios serves some particular purpose.

## 4.2 LIQUIDITY RATIOS ANALYSIS

Financial ratios used in determining the liquidity position of any company are divided into two (2) categories. They are the Short-term Ratios or Liquidity Ratios, and the Long-term Liquidity Ratios called Debt Ratios.

Liquidity Ratios are concerned with a company's ability to meet its short-term obligations and the two (2) commonly used are CURRENT RATIOS and QUICK RATIOS which provide a general picture of adequacy of working capital and the ability to meet daily cash obligations of the company.

## 4.3 PEUGEOT AUTOMOBILE NIGERIA LIMITED - BACKGROUND HISTORY

The history of what has now become Nigeria's favorite car dates back to 1975 when individuals into the country imported 100 units of Peugeot 203 cars. Two years later, SCOA was appointed sole agent of Peugeot cars and she imported the first set of 403 Peugeot cars. Since independence in 1960, however, the growth rate of the Nigerian economy had taken such a proportion that the number of imported cars could no

longer satisfy the need, therefore, to meet up with that demand, the then military Government of Nigeria opened negotiations with Automobiles Peugeot of France for the setting up of an assembly plant in the country. That dream became a reality when on December 15, 1972, Peugeot Automobile Nigeria Limited was incorporated with an Authorized Share Capital of N3 million, and Paid Up Capital of N2 million.

On March 14, 1975, the assembly plant in Kaduna was commissioned by the then Head of State, General Yakubu Gowon, and the first Nigerian Peugeot car rolled out of the plant.

### 4.3.1 **OWNERSHIP AND MANAGEMENT**

Peugeot Automobile Nigeria Limited was founded in August, 1972 by an official agreement signed between the Nigerian Military Government and Automobiles Peugeot of France. The company's equity structure stands at:

| | % |
|---|---|
| Federal Government of Nigeria | 40% |
| Kaduna State Government | 4.7% |
| Katsina State Government | 5.3% |
| Nigerian Peugeot Distributors | 10% |
| Automobiles Peugeot, France | 40 % |
| | 100% |

The company's policy affairs are looked after by a Board of Directors headed by a Chairman, while the general management structure is headed by a Managing Director, assisted by a Deputy. There are five (5) major divisions. These are:

- Personnel
- Commercial
- Finance
- Industrial, and
- The office of the Managing Director

A General Manager heads each of the divisions.

## LIQUIDITY RATIOS ANALYSIS

Financial ratios used in determining the liquidity position of any company are divided into two (2) categories. They are the Short-term Ratios or Liquidity Ratios and the Long-term Liquidity Ratios called Debt Ratios.

Liquidity Ratios are concerned with a company's ability to meet its short-term obligations and the two (2) commonly used are CURRENT RATIO and QUICK RATIO. They provide a general picture of adequacy of working capital and the ability to meet daily cash obligations of the company.

## CURRENT RATIO

As indicated in the Appendix A2, Peugeot Automobile had the highest current ratio of the period under review in 1987 with 1.269 while the lowest is 1.037 in 1993. This means that the company does not have the accepted standard of 2-1 in any of the ten years. This means the company is illiquid. However, care must be taken in drawing

conclusions as a high ratio may be due to excessive stocks, large cash holding or slow paying debtors. It is therefore important to look into the quality of the current assets.

The values of these ratios are positive with little fluctuations.

- Current ratio relates working capital items in balance sheet.
- The "Rule of Thumbs" feels comfortable with 2:1
- Excess may be from over stocking, uncentralized cash, or poor credit control.

**QUICK RATIO**

- Quick ratio relates short obligations to "quick" funds.
- The "Rule of Thumbs" averages 1:1, lower indicates no stress, and higher may be under-utilized cash or poor credit relations.

  It was less than one through out the period, meaning that the company had more current liabilities than liquid assets. The low ratio indicates financial instability now and in the near future. In the period, the highest value was 0.693 in 1988 while the lowest value was 0.246 in 1994.

**SALES TO WORKING CAPITAL**

This ratio shows how working capital changes affect sales level.

A 10% increase in sales will require a 10% increase in working capital.
The ratio is fair and this indicates that Peugeot Automobile Nigeria Limited did not face problems associated with slow movement of stock especially in 1993, 1992 and 1994 with the values of 72.921, 52.251 and 48.183 respectively.

## DEBT RATIO

Debt Ratios deal with long-term liquidity of the firm. Those interested in these ratios are mainly long-term creditors and shareholders. All debt ratios indicate the financial structure and competitive position of the firm.

The debt ratios are Current Debt to net worth, Total Debts to net worth, and Total Debt to Total Assets, etc. The lower any debt ratio, the better for the company because it shows strong ownership position and management. The debt ratios of Peugeot Automobile Nigeria Limited are low and the mean is within the same range.

## TOTAL DEBT TO NETWORTH

Any high ratio indicates financial problems during the period. Hence the company has more debts than investment as capital. Thus, the higher the debt the more restricted and confused the management is, for, it has to continue thinking of redeeming them.

## 4.4 PROFITABILITY RATIO ANALYSIS

The financial ratios used in determining the profitability of any company are:

- Activity or performance ratios.
- The profitability ratios.

Both types of ratio aid in the evaluation of the firm's operational performance and the value of some of these ratios are depicted graphically in the appendix.

## RETURN ON CAPITAL EMPLOYED

Under this, the denomination can vary with Total Net Assets, Total Assets, and Shareholders' Fund.

The return on capital employed is the primary (main) ratio.

## NET PROFIT MARGIN

If the Asset Turnover Ratio multiplies the Net Profit Margin, we obtain Return on Capital Employed.

Both net profit margin and asset turnover ratios are called secondary ratios.

## INVESTORS (STOCK EXCHANGE) RATIOS

The growth in earning per share is used to measure the company's success.

Price Earnings Ratios reflect investors' expectations about growth in the firm's earnings.

For high-risk companies, normally, Price Earnings Ratios are low while they are high for growth potential companies.

Earnings Yield indicates return on current market price of shares.

Dividend Yield measures dividend return on current market price.

Dividend Cover measures number of times earnings can cover dividend paid.

## 4.5 ACTIVITY RATIOS

The Activity Ratios measure a firm's effectiveness at employing its resources and include Inventory Turnover, Average Collection Period, Current, Fixed, and Total Asset Turnovers, etc.

These ratios actually indicate financial strengths and weaknesses.
Average payment periods show that shorter collection/longer payments are more desired. However, credit-worthiness should not be sacrificed for longer payments.

Debtors Turnover indicates the number of times that debtor's turnover each year. It measures proportionate collect ability of debts.

Stock Turnover shows efficiency of the firm's inventory management. It equally shows how fast stock converts to debtors through sales.

Fixed assets turnover shows the efficient utilization of fixed assets in generating sales revenue. The fixed assets turnover could be varied to replace fixed assets with total assets or capital employed.

### SALES TO FIXED ASSETS

It tells how effectively a firm is using its fixed assets for producing goods to be sold etc. The more they are utilized, the more efficient the company is. The higher the ratio, the more competent the company is and it also tests the adequacy of the sales volume. It also indicates that some or all of the company's assets are leased or rented.

## TOTAL ASSETS TURNOVER

The Current Assets and Fixed Assets contribute to the production and sales activities of a firm, thus it is necessary for a firm to manage its total assets efficiently.

## SALES TO EQUITY

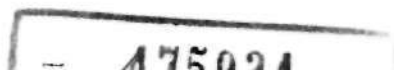
High ratios show that a company is over trading, while low ratios show under trading. Over-trading is a condition in which the sales are much more than the amount invested by shareholders while under trading is when sales do not cover net worth. When sales are equal to the equity, the company is neither over trading nor under trading.

## INVENTORY TURNOVER

This indicates the efficiency of the firm's inventory management. The smaller the inventory level needed to support a given volume of sales, the higher the Turnover Ratio and the better the inventory management.

## FIXED ASSETS TO NETWORTH

It measures the extent to which the Net Capital employed by a company is used to purchase Fixed Assets. Since every company has a limited amount with which to operate, excessive investment in any area will result in additional borrowing, and inadequate profit. High ratios show excessive investment and very low ratios show the reverse. Over investment in fixed assets will however always result in poor credit rating.



### WORKING CAPITAL TO TOTAL ASSETS

This ratio is a measure of the Net Liquid Asset of the firm relative to the Total Capitalization. It shows greater statistical significance both on a Univariate and Multivariate basis and Altman as the best indicator of Ultimate Discontinuance regards it.

### WORKING CAPITAL TO SALES

This indicates the lack of available cash to meet financial obligation.

## 4.6 PEUGEOT AUTOMOBILE NIGERIAN LIMITED - ANALYSIS

### SALES TO FIXED ASSETS

Fixed assets were not followed by an increase in sales volume. It therefore shows that fixed assets were not effectively utilized. It shows inefficient utilization to produce profitable sales. The lowest value is 2.845 in 1987.

### TOTAL ASSET TURNOVER

It was very low and declined. This means that expansion in total assets was not accompanied by increases in sales. Thus, Sales was not commensurate with the Total Assets.

### SALES TO EQUITY

The sale was not too high, though it indicates that Peugeot Automobile is over trading.

## INVENTORY MANAGEMENT (TURN OVER)

There was a fluctuation in this value. It therefore generally shows that there was efficiency in inventory management.

## FIXED ASSETS TO NETWORTH

This ratio is above average. This shows that the company investment in fixed assets was not excessive thus the degree of utilization of the fixed assets virtually remained the same.

## WORKING CAPITAL TO TOTAL ASSETS

The values are all positive. This shows that the company has a surplus working capital. It is likely to be able to meet the obligations of stocks, of assets and liabilities. It is so because the liquid assets at hand discharge the cost of operations, and current liabilities instead of by the net cash flows emanating from Sales.

## PROFITABILITY RATIOS

They include a profit margin on Sales, Earning Power, etc. The profit margin on sales is the only profitability ratio that yields information about the cause of financial distress. This is the only one that indicates the cause of strengths and weaknesses of firms but others indicate financial structure and /or competitive position of the firm.

**NET PROFIT MARGIN**

The company's net profit to net sales was quite unimpressive during the period. It had the highest value/percentage of 5% in 1984. It declined and remained very low through out the year.

**RETURN ON TOTAL ASSETS**

The ratios are low for the company and positive for the period under review.

**RETURN ON INVESTMENT**

The earnings were not very low. Therefore, the company's performance was fair.

**AVERAGE COLLECTION PERIOD**

This is desirable if shorter collection and longer payments are made.

## 4.7 PERFORMANCE EVALUATION OF THE FIRM

**1984**

In this year, Peugeot Automobile Nigeria Limited has had a very active year and has set in motion a determined effort to improve operations, profitability, and manpower development.

## THE OPERATING ENVIRONMENT

The glut in the oil market with the prevalent economic recession persisted throughout 1984 with a crushing debt-servicing burden consuming about 30% of the 1984 Foreign Exchange Earnings. The Government was faced with the matrix of allocating the available foreign exchange into categorized sectional priority grades of importation. Cash flow budgetary control was introduced, and allocation of foreign exchange restricted to available exchange earnings. With the high level of foreign exchange requirements by the company to operate at a profitable capacity, the company had to negotiate and obtain a second $200 million foreign loan from French Consortium Banks. This loan in addition to the conventional license granted to PAN in 1984 allowed for a more smooth production programme for 1984 resulting in increased production of from 36,727 cars in 1983 to 44,323 in 1984. (Annual Report; 1984:5).

Thus, the Debt-Equity (Earning) Ratio in the year was 0.084 while the Debt-Capital Employed was 0.056 and the Operating Ratio was maintained at 0.857.

## TRADING RESULTS

Despite above 30% under-utilization of production capacity in 1984, the operating results for the year were the best since the incorporation of the company. With a turnover increase of 43% in 1984 over 1983 (from N344.8 million in 1983 to N493.6 million in 1984), net operating profit rose from a loss situation of N0.6 million in 1983 to a profit of N27.9 million in 1984. With a stringent cash management and control added to the level of operating profit, the company cash position improved remarkably with a net cash inflow of N83.3 million, transforming a net overdraft situation of N50.6 million in 1983 to a favorable net cash at bank balance of N32.7 million in 1984. Thus, Return

1984. The committee produced a completely new chart with appointment of Nigerian Deputy Managing Director Finance, and the Commercial and Personnel Divisions have now been nigerianized. A total of 14 expatriates are expected to depart by the end of 1985. Nigerian under-studies have been, or are now, in the process of being appointed for essential positions currently held by expatriates in the company.

The Board, in the pursuit of speedy Nigerianization, is aware that competence and effectiveness must not be sacrificed. There is great need for Nigerian and our expatriate staff to work with mutual trust and confidence to affect a smooth transfer of skill.

**1985**

**ECONOMIC OPERATING ENVIRONMENT**

The economic recession, which has plagued the economy of Nigeria for the last two years, continued through out 1985. The glut in the demand for oil together with over production of crude oil by both OPEC and Non-OPEC members reduced the price to an all time low of $5 and caged Nigeria within the clutches of balance of payment crises. In August 1985 Britain reduced her North Sea Oil price and being of the same grade with Nigerian Oil, Nigeria was forced to follow suit in the oil price reduction. The shrinkage and dwindling revenue to the Federal Government provided immediate impetus for reassessing and re-ordering the country's economic priorities and for installing a more efficient and effective monitoring and control systems in the allocation of foreign exchange.

The year under review also witnessed the military change of government in August 1985 from the erstwhile Major General Buhari's military administration to Major General Ibrahim Babangida as the President of the new Federal Military Government of Nigeria. The new government ushered in a new emphasis on economic reconstruction and restructuring, social justice, self-reliance and rural development. It appointed a seven-

man committee on IMF through which Nigerians totally rejected the IMF loan. With the rejection of the loan, coupled with the over-exposure of overseas banks, confirmation lines became very restricted by the overseas correspondent banks and the President, in October 1985, was given wider powers for the regulation and management of the economy under the enabling decree establishing the 15 months economic emergency.

PAN, within the Macro-economic set up, was affected by the grave economic realities of the country. The company was allocated lower import license than in 1984, which resulted in 58 days closure and significant under-utilization of installed capacity. The negotiated counter-trade arrangement for $200 million was stultified by demand fluctuations in the oil prices resulting in an actual net utilization of only $73 million. The company had to fall back on a new $200 million French Consortium loan finalized towards the end of 1985. (Annual Report and Accounts; 1985:6).

## TRADING RESULTS

Turnover for 1985 was N456.6 million against N493.6 million in 1984, a reduction of 8%. The decrease in turnover stemmed from a lower unit production/sales for 1985 consequent on reduced level of import license. Profit Before Tax went down by 28% from N27.9 million in 1984 to N19.9 million in 1985.

The principal factors that accounted for this significant reduction in profit were the 19% drop in the Naira exchange rate and lower turnover. It is note-worthy that a total of N80.6 million was expended in 1985. Interest costs were drastically reduced while the new cash balance of N41.2 million in December 1985. It is also noteworthy that the company operated on a net cash position throughout the year and generated

significant interest income on short-term deposits. The company's contribution to the Federal Government purse in 1985 included N83.6 million payments for customs duty, N20.8 million payments for excise duty and N9.1 million payments for taxation.

## DIVIDEND

In continuation of our avowed policy of internal sourcing of our expansion programme in naira terms, in addition to the caution to provide a buffer against adverse liquidity effect of the second tier market, the company now recommend for approval of dividend of N1 million on 1985 accounts.

## LOCAL CONTENT DEVELOPMENT

The company recognizes the need for total dedication and institution of practical programmes towards real backward integration for sourcing of raw materials. In this regard, emphasis must be placed in persuading industrialists to go into "down stream" industries including petrochemical industries, flat sheets, tooling factories, foundries and stamping plants. Even with this fundamental industrial base deficiency, the company has produced over 15 proposals for projects, which are considered to have short pay back periods, foreign exchange savings and in-roads into automobile technological transfer. These proposals have been sent and are currently under study by the Federal Government.

## FUTURE PROSPECTS

The Federal Military Government has introduced the Second Tier Foreign Exchange, Market (SFEM). The Second-tier market is a 'proposal' market, where Naira will be allowed to find its own level of exchange rate through systematic forces of supply and demand adjustments. With the enabling act, which should define the modalities for

implementation as well as introduce a new tariff structure, not yet promulgated, it is too early to give a finite assessment on how the new system will affect PAN. It will however, appear that the new system will engender some new impetus into industrial activities, with every industrial establishment able to bid for foreign exchange without the handicap of import license.

There have been various pronouncements on this issue, ranging from too much optimism to sheer skepticism. The system is likely to come into operation by October 1986. Questions which the company will address herself to within the new system include: pricing policy, government guidelines with regards to importation of built-up cars, car demand curves given the expected price increases, and consequences on production.

The Chairman, in his statements, maintained that the company was allocated a N3 million-import license for 1986 in addition to the carry over of the $200 million French consortium loan finalized towards the end of 1985. The total available CKD under these licenses have now been completely utilized and the company is currently on an indefinite closedown. The company has, however, made proposals to the Federal Government, which should ensure speedy re-opening of the factory.

The company anticipates a speedy reaction from the Government on the early re-opening of the company given the adverse effects of a long and indefinite closure. Every indication points to the fact that the best the company can achieve in 1986 would be a breakdown, given the colossal loss attendant on foreign exchange losses on current outstanding overseas debts, which would suffer the continual depreciation of the naira. The present staff strength of the company is 3,500 employees. The company hopes that the Federal Government would favorably consider the company's new

financial proposals early and revive the confidence of the company (Acting Chairman's Statement; 1985:8).

**1986**

1986 may be described as a year of economic topsy-turvy for Nigeria. The recession, which characterized the economic performance in the last four years, continued unabated. The impact of the drastic measures as enunciated by the President and Commander-In-Chief of the Armed Forces, Major-General Ibrahim Badamasi Babangida in October 1985 under the package of economic recovery programme started to be felt during the early days of 1986.

**ECONOMIC ENVIRONMENT**

These measures (Economic Recovery Programme) included the reduction of about 50% on fuel subsidy, the imposition of the National Economy Recovery Fund, and a 30% levy on all imports. Despite all these measures, the price of oil, the single product on which the Nigerian economy depended for her foreign exchange earnings, slumped. The aggravated collapse of the oil market brought a shattering scenario to the revenue expectations and budgetary hopes of the country. The oil prices plummeted from $28 per barrel to below $10 per barrel. By the middle of 1986, there were enough indications that the government measures could not arrest the ailing economy. On the international scene, correspondent banks refused to confirm letters of credit raised by Nigerian Banks while the country could not meet her debt servicing obligations. In the face of these critical negatives, it was clear that monetary and fiscal policies were not having the desired effects.

By July 1986 the Federal Government of Nigeria launched the Structural Adjustment Programme (SAP), which brought about the most revolutionary changes with a high

level of clear-headed conceptualization aimed at resettling the national economy on a healthy course of development. The principal tool for the implementation of SAP was the Second-Tier Foreign Exchange Market - SFEM (now FEM after the merger of the 1st and 2nd tier markets). SFEM - a market where the naira could find its own rate under free market operation - had the objective of accelerating economic growth, through the attraction of foreign capital, investment, and the deregulation of the structures of the national economy. Experience so far does indicate that the major objectives of SAP are still to be achieved. (Annual Report and Accounts; 1986:7)

The initial trauma of the sudden change coupled with the drastic liquidity squeeze, frozen wages and salaries, and increased unemployment operated to reduce effective demand for goods to unmanageable proportions. Many manufacturers are now faced with costly financing of working capital, especially raw materials and finished products. The company is very optimistic on the resilience of the Nigerian economy and the company and the efficacy of the numerous government measures.

**TRADING RESULTS**

Against this adverse operating economic environment, the operations in 1986 could be divided into three periods. The months of January to May 1986 was the period when government introduced a 30% import levy and other cost-push measures which increased PAN's overall cost by 27% while she was only allowed a "political" price increase of 10% which had unfavorable consequences for its manufacturing performances. The second period was from July to September when, due to lack of import license (PAN was granted only N3 million license for 1986) the factory was mostly shut. With the months of September to December 1986 came the introduction of SFEM and the attendant high bidding and treasury costs and subsequently the prohibitive unit prices of cars with very low effective customer demands.

It was under these conditions that the company marginally increased her turnover from N456.6 million in 1985 to N479.7 million in 1986. This increase in turnover was purely as a result of unit price increases. Actual unit sales decreased from 35,655cars in 1985 to 26,781 cars in 1986, a decrease of 25%, consequent on production reduction from 36,574 cars in 1985 to 27,024 cars in 1986. With the installed capacity of 60,000 cars per annum, capacity utilization in 1986 was 44%. Net profit before tax stood at N2 million as against N19.9 million in 1985. The main reason for this situation was the none recoupment of the 30% surcharge and the loss on exchange, which drastically reduced the operating, margin. Due to stringent cost control exercises embarked upon by the company, fixed overhead costs were reduced by approximately 20% despite heavy financial costs encountered during the last three months of the year, resulting from SFEM bidding. Spare parts operations maintained a dominant contributory role as the motoring public now turned to the repair and maintenance of old cars rather than the purchase of new ones at current SFEM prices. The company closed down for 98 days in 1986 as against 58 days in 1985.

## DIVIDEND

In recognition of the low profits of 1986 and the need to provide a buffer against the present financial squeeze, the company never recommends the payment of any dividend in 1987.

## LOCAL CONTENT DEVELOPMENT

In continued appreciation of the expected need for total dedication in backward integration, PAN embarked on major local content development programmes. To finance these programmes, which have very short pay back periods and significant foreign exchange savings, PAN negotiated an off shore French Bank Consortium loan. Details of these proposals/prospects were submitted early in 1986 to the Federal

Government and due to delay in government approval, PAN has embarked on a general policy review with a high view to selecting those projects which are both labor intensive and fundable under FEM and under Local Bank Consortium loans.

## FUTURE PROSPECTS

The current liquidity squeeze combined with disastrous effects of SFEM on car prices have created dramatic down turn in effective demand for cars far beyond original projections. A continuation of the squeeze should naturally increase the concern of many manufacturers who not only have to pay for raw materials in advance through SFEM bidding but also have to finance stock of finished goods due to sluggish demand curves. (Annual Report and Accounts; 1956: 8-9).

In meeting the challenges posed by the new economic realities, the company has embarked on a number of survival strategies aimed at stimulating effective demand and activity diversification initiatives have now been developed in the following areas:

(a) Trade-in/Car Reconditioning: Customers are asked to trade in their old cars in exchange for new ones. These activities have started to gather momentum and indications are that turnover could be improved by an additional 10%.

(b) New Range: PAN has launched new products:

1. 505 Station Wagon delivery van
2. 205 Salon Car
3. J5 Bus

Reactions to the J5 mini-bus are very promising and with its 505 mechanism, it has a very good future.

(c) Export: PAN has already scored a major break through in the export market with sales to Benin and Chad Republics. The new activity with proper incentives is hoped to culminate in a dynamic market and marketing mix with the objective of increasing turnover and acquisition of foreign exchange for future use by PAN.

The company anticipates that given the current favourable indications in the economy, viz: new high oil prizes of about $20 per barrel, $1 billion loan from World Bank on favourable terms, and the current FEM bid rates, the company should pick up enough activities to break even in 1987. It is going to be a year of difficulties but the companies with its management staff are determined to meet the challenges of the future. (Chairman's Statement; 1986:9).

**1987**

**ECONOMIC ENVIRONMENT**

The year 1987 was a year mostly characterised by the familiar economic recession dominated by the down ward oscillations of the value of the U.S Dollar against other internationally traded currencies. At home, the decline in the value of U.S. Dollar had direct negative effect on the country's ability to pay for import bills. In addition, the diminishing level of foreign exchange earnings by Nigeria coupled with severe debt servicing obligations fueled the economic crisis for 1987. The full impact of the Structural Adjustment Programmed (SAP), which remained the principal instrument of the nation's economic policy, was felt throughout the year.

Amidst the liberalization of market forces, including the market-determined rate of exchange for the Naira, abolition of price control, market determined interest rate, the economy recorded a marginal increase of 1.2% in Gross Domestic Product (GDP) in

1987. In reality, the dilution of the national economic crisis was only marginal. Significant success was, however, recorded in debt rescheduling for repayment due in 1988/89 with the signing of the Paris Club agreement.

On the foreign exchange market, the value of the Naira continued to decline, while the amount of Dollars available for bidding continued to be below demand level. However, access to foreign exchange was easier for manufacturers when compared with the import-licensing era. While welcoming the new custom duty regimes, which for the first time have a seven-year life span, enabling effective planning decisions to be made, obvious anomalies, which have been clearly identified, should be amended by the government.

For the company, the tight liquidity squeeze, high unemployment and low capacity utilization with attendant high unit cost resulted in gross reduction of effective demand for cars. The FEM adjusted higher price to tag for cars in an economy beset with low liquidity, reduced the company's sales to an all time low. The year under review has been a very difficult one for the company. In fact, it was a year the company was subjected to severe survival test and happily passed that acid test.

## OPERATING RESULTS

Turnover for the year ended December, 1987 was N282.7 million against N478.8 million in 1986, a net reduction of 41% of 1986 figure. In car sales, 1987 activities represented only 21% of 1986. This dramatic fall in unit sales represented the negative impact of Structural Adjustment Programme (SAP). With low liquidity and initial near public rejection of the new car prices, the company developed effective and aggressive marketing strategies which included new vehicle range, significant entry into spare parts market, rationalization of existing car models and dynamic export drive. In addition, she quickly adjusted by pruning down her operating cost, reducing drastically

most of the fixed costs aid and reducing her staff level in cognisance of the new level of production. The abolition of price control enabled PAN to operate at a more realistic gross contribution. The net result of these positive actions were that operating profit before tax improved from N2.0 million in 1986 to N4.3 million in 1987, representing a 100% improvement on 1986. The company attributes credit for this improved performance in operating profit to effective resource management.

## LOCAL CONTENT DEVELOPMENT

In the Chairman's statement last year, he highlighted the high premium the company places on both in-plant and out-plant local content development programmes. In continued recognition of the leadership role in the automobile industry that the company continues to play, the company has reinforced her confidence in the resilience and growth of the economic activities of Nigeria by intensifying her in-plant local content development. The Chairman mentioned last year also that the company had embarked on a general local content policy review with a view to selecting those projects which were both labour intensive and fundable through FEM under local bank consortium loans. This exercise has now been completed and major projects have been selected for implementation and take off in 1988/1989. These projects would contribute an additional 15% of local integration with a total naira value of about 20 million.

The loan negotiation with the consortium of banks is at an advanced stage and the fund would be available soon for utilization. (Annual Report and Accounts; 1987:6).

## DIVIDEND

In recognition of the ambitious and dynamic in-plant local content development programme now embarked upon, which will be partly financed by internal sources, the company recommends no dividend payment in 1988.

## STAFF AND MANAGEMENT

Collective effort, loyalty, and dedication were recorded in the face of soaring inflation, redundancies and uncertainties, which culminated in severe hardship for all workers. The company maintained healthy industrial relations while impressive strides continue to be made in the Nigerianization of senior management positions.

## FUTURE PROSPECTS

Sales per day up to the end of the first six months of 1987 averaged 1/20th of the 1983 and 1985 figures. The company embarked on extensive market drive and the second half of 1987 achieved a major break-through, with sales doubling those of the first half of the year. The trend has been maintained and improved upon ever since. By the first half of 1988 the company had already sold the same number of cars as she did in the whole of 1987.

According to the Chairman, "this effective demand momentum is still with us and is hoped to be maintained for the rest of 1988 provided the company continues to secure enough foreign exchange for purchase of CKD on the FEM bid market. A new range of mini-bus of mass transportation has been introduced is well accepted by the market. The Structural Adjustment Programme has changed the company's customer base from individual purchases to purchases by corporate bodies, parastatals and public

institutions. The government reflationary measures are already evident in the level of current demand and provided the company continues to obtain satisfying level of foreign exchange for importation of components, the company looks forward to a successful 1998. (Chairman's Statement; 1987:7).

**1988**

The main economic policy instruments of the Structural Adjustment Programme continued throughout the year. Trade liberalization, privatization and commercialization of some parastatals were also intensified. Although the Federal Government produced a reflationary package under the 1988 budget in order to ameliorate the strangulation of the 1987 budgetary measures, the debilitating impact of national debt servicing marred meaningful economic growth.

**ECONOMIC ENVIRONMENT**

With the market drop in oil earnings during the first 6 months of the year, the expected national revenue experienced a significant reduction. With this resultant strain on the government's ability to meet the company's budgeted foreign exchange commitments, the company reviewed downward her plans for the year. The result was that pressure mounted on the naira under the reflationary economy and there were too many Nairas chasing few dollars.

In addition, all parastatals and government establishments who previously received special sectoral allocations from the Central Bank of Nigeria (CBN) were asked to bid at the foreign exchange market without the CBN providing any additional increase in the funds available in the market. The lack of foreign exchange allocation from the

banks literally suffocated the company's activities and thus consequently reduced production volume below 8% of the installed capacity.

## INDUSTRIALIZATION

Despite the very gloomy investment climate within the economy and PAN's uneconomic production levels, the company decided in favour of, and infact, pursued a fundamentally aggressive in-plant local content development programme by critically identifying and prioritizing projects with high foreign exchange savings and low pay back periods. The company as a result launched four in-plant activities with each on its own forming a catalyst and basis for future industrial expansions while at the same time actively supporting two out-plant projects.

## IN-PLANT PROJECTS

### Engine Assembly:

Under a special engineering effort, car engines are now being assembled and tested to European standards. This new activity will permit the progressive development of many new projects for the local manufacture of new parts and components such as filters (fuel, oil and air) and machined parts (sleeves, pistons, crankshafts, shaft bearings, fly wheels, etc).

## TOOLING WORKSHOP

A tooling workshop has also been established in PAN. Under the operations of the workshop, 10 tools for pressed parts would be manufactured every month and the end of 1990 would in addition stamp small sized parts.

**PRESS SHOP:**

The company has a press shop competent enough to press all parts requiring press machines of up to 120 tons and able to press about 250 parts.

**MACHINING:**

This activity envisages the machining of flywheels, sleeves for the company's assembling activity and the spare parts market, pulleys, and manifolds. With the above activities now fully engaged in or planned for, the company now turns to the Federal Government of Nigeria for a supportive policy option. It is ardently hoped that this policy option would include the strict restriction of vehicle importation for both new and second hand ones. This would guarantee some protection for our production volume and improve feasibility for local production of components. This advocated policy option is fully in place in other third world countries like Brazil, India, Argentina, Thailand, Korea, China, and Mexico. Even Eastern countries such as Hungary and USSR have adopted the same policy.

In the industrialized world, the automobile industry is one of the key barometers for measuring industrial activities, employment potentials and industrial development. The industry is also a capital-intensive one. The heavy financial demands under the Structural Adjustment Programme has increased the purchase cost of machines and tools about ten fold, thereby constituting a disincentive for investment under this sector. It is the company's hope that government would use the tariff rates to create and

invigorate industrial incentives and pave a way for increased investment in the automobile industry. To this end, the company has made several suggestions, appeals and recommendations to the Federal Government. The company has also made submissions to the government for effective tariff standardization for similar components used commonly by both cars and light commercial vehicles.

The present mode of IFEM allocation can also be improved upon by the devising of adequately monitored sectoral allocations of foreign exchange, which would guarantee sufficient production activities for the manufacturing sector of the economy and be able, at the same time, to satisfy the feasibility of new investments within the industry. This assistance from government, when given, will surely act as a new impetus towards the full realization of the company's main objective of developing components and parts locally.

**EXPORTS:**

Significant strides were taken in market penetration into the West African Sub-region. Contacts were also made into a wider export market and given marginal incentives by the government. 1989 should consolidate and expand these markets.

**DIVIDEND:**

In recognition of the need to encourage shareholders, the company recommends that dividends be paid from the 1988 Net Profit.

## FUTURE PROJECTS:

The future prospect for the automobile industry in Nigeria rests, to a great extent, on aggressive local content development. Given the meaningful growth trend in production levels capable of sustaining the feasibility of new projects, the company has embarked on a steady momentum for both in-plant and out-plant developments. The company's activities in 1989 would rest squarely on the level of foreign exchange allocations obtained by it at IFEM. It is gratifying to note that the Board and Management, in harmonizing there past experiences, drawing from their creativity on the united opportunities of the present, have ensured continuous production for the rest of 1989.

## STAFF AND MANAGEMENT:

The management and staff maintained admirable good relations despite the very difficult economic conditions within the country.

## 1989

## ECONOMIC ENVIRONMENT

The world economic scene was characterized by the challenges brought about as a result of the difficulties of external debts management, which had now attained crisis level amongst third world and developing countries. In Nigeria, the economy continued to be dominated in line with third world countries by the external debt burden, with the attendant debt servicing difficulties. The Structural Adjustment Programme (SAP) remained the main policy instrument on economic issues. The 1988 reflationary policy tended to have overheated the economy with the resultant high rate of inflation. To arrest the situation, the government introduced various regulatory policies aimed at mopping up excess liquidity in the banking system. The Central Bank of Nigeria (CBN)



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was seen to be active throughout the year both as a regulatory and monitoring institution within the banking industry. Stringent credit growth policies were introduced and government gave directives for all parastatals and other government agencies to withdraw their deposits from commercial banks into the CBN. This resulted in a near crisis nerve-breaking liquidity squeeze. In search of new funds, interest rates were raised to an all time high level with resultant high production costs. By the middle of the year, the Federal Government introduced some SAP relief measures, which, among other things, reduced the import duty payable by commercial vehicle assembly plants.

Unfortunately, this relief package did not benefit the car assemblers, but marginally favoured the importation of fully built up units such as the J5 buses. Installed industrial production capacities were still heavily under-utilized. The chairman maintained that: In our case we produce at about 13% capacity. However, despite these problems, the Gross Domestic Product (GDP) for the country achieved about 4% growth level. There were marginal improved performances in sectors such as agriculture, finance and insurance, with petroleum accounting for the major increase. Due to a higher price per barrel of oil, the combination of higher revenue from crude oil export against the 1989 budget, added to increased production quota, ensured a significant growth in this sub-section.

There was a significant increase in the number of licensed banks in 1989 and despite liquidity problems; there was a remarkable positive contribution within the financial sub-sector.

**INDUSTRIALIZATION:**

In continuation of this organization's determination to embark on a progressive and fundamentally aggressive in-plant local content development programme, the

company, in 1989 spent over N10 million in further development of the tooling workshop and machining, in addition to new investment in the out-plant development of plastic and rubber parts. These are all aimed at increasing the stamping and machining of parts within the company. This is a further testimony of our total confidence in the future economic development of the automobile industry, which in itself forms one of the barometers through which any nation's industrial activities, are measured. It is the company's fervent hope that in the current dialogue with the Federal Government, the company will find a meeting point where favourable incentives and assistance, both in terms of favourable tariff review and protection, are given to the assembly plants: (Annual reports and Accounts; 1989: 5).

It is important, nevertheless, to mention that the company now assembles Peugeot engines in-plant, machines its own engine flywheels, and manufacture tools every month for its press shop. The press shop is capable of pressing all parts requiring press machines of up to 120 tons and presses more than 250 parts. The in-plant assembly of the engine opens up a new vista of industrialization as it permits the progressive development of many new projects for the local manufacture of new parts and components.

On the popular issue of the Nigerian car, shareholders are assured that facilities exist in the company for this, and the company intends to play a key role towards achieving these objectives. The programme is receiving serious attention.

**TRADING RESULTS**:

As in 1988, the performance of the company in 1989 was totally dominated by the level of foreign exchange available to the company. The consideration of the increase in the number of banks, coupled with the liquidity squeeze within the first three quarters of

the year, had made availability of foreign exchange very difficult for this organisation. Combination strategies aimed at increasing the availability of foreign exchange were developed, including massive expansion in the number of banks used. Nonetheless, the quantity of foreign exchange obtained through these strategies was insufficient to meet the company's demand curve. Turnover for the year increased from N618 million in 1988 to N714 million in 1989, a net increase of 15.5%. The increase was accounted for principally by the increase in the unit-selling price. In unit's terms, 5,394 cars were sold in 1989 as compared to a total of 10,807 cars in 1988. The significant decrease in the unit sales was accounted for by the scarcity of foreign exchange.

Sadly enough, statistics from the ports confirm that average monthly imports of imported vehicles through the Lagos ports amounted to about 1,450 vehicles in the first seven months of 1990 as compared to 1,100 vehicles in 1989. This represents an increase of 32%. These imports, which are significant, have created difficulties in maintaining our market share. Representatives have, however, been sent to the appropriate authorities to once more address the issue and protect the local industry. The positive reaction of government is being awaited towards this end.

**1990**

**INVENTORIES**:

Inventories are valued at the lower of cost, on a first in, first out basis, and net realizable value after making due allowance for any obsolete or slow moving items. In the case of finished vehicles and work in progress, cost comprises direct materials, direct labour, and an appropriate proportion of manufacturing fixed and variable overheads. The allocation of manufacturing fixed overheads has regard to budgeted normal production.

**PENSION COSTS:**

Pension costs are recognized on a systematic basis, so that the costs of providing retirement benefits to employees are evenly matched, as far as is possible to the service lives of the employees concerned.

**FOREIGN CURRENCIES**:

Transactions denominated in foreign currencies are recorded at the rates of exchange ruling at the dates of the transactions.
All monetary liabilities and assets denominated in foreign currencies are translated at year-end exchange rates and the resulting exchange differences are dealt with in the determination of profit for the financial year.

**1991**

**GLOBAL ECONOMY:**

The economic and political climate for the year under review was dominated by various major world events, namely, the cataclysmic political changes, not only within the former Soviet Union but throughout Eastern Europe, and the unification of East and West Germany, culminating in a near protectionist German economic policy. The second major event was the global economic recession, with America experiencing one of her lowest levels of production in economic activities, and thirdly the Gulf War and its aftermath.


KASHIM IBRAHIM LIBRARY

It was a year characterized by turmoil resulting in further balkanization of countries like Yugoslavia. The combination of these major events yielded unstable world economic activities and further gradual, but practical, political and economic marginalisation of the developing counties, especially the African countries.

The world also witnessed unprecedented inflation, sluggish trade, and massive increase in unemployment. The dollar, which is still the reference and dominant world currency, suffered devaluation, which technically increased the burden of Nigeria's external debts.

For African countries, in anticipation of and as a wedge against the resultant economic isolation arising from the political cum economic union of the EEC countries and the democratization and balkanization of Eastern Europe, African Heads of State signed the Treaty of African Economic Community (AEC) at their Abuja Conference in May 1991. It is hoped that the practical and effective implementation of this treaty will herald a new preparation to face the challenges of the future.

**DOMESTIC ECONOMY:**

Against the background of world economic recession and confirmed oil price reduction, the Nigerian economy recorded a 4.3% marginal increase in its Gross Domestic Product (GDP). Outstanding external debt stood at over $32 billion. In the Manufacturing and Industrial sub sectors, productivity increased slightly by 2.1% and 0.8% respectively. There was, however, a gradual implementation of measures initiated by the Federal Government to create healthier grounds for national development. These various regulatory policies kept the economy in line with the Structural Adjustment Programme.

The Central Bank of Nigeria, on its part, maintained a constant presence in the financial system with inflation control mechanisms such as stabilization policies, which mopped up excess liquidity. With "pegging" of both the interest rate and the foreign exchange rate, demands for higher volume of foreign currencies resulted in exceptionally higher costs, which affected the selling price of our products and profit margin. The importation of fully built-up cars and used vehicles (Tokunbo) continued throughout the year and the company suffered adversely as a result of the diminishing market protection and loss in market share. The Transition to Civil Rule Programme remained on course during the year with the successful conduct and completion of the Local Government Elections, Gubernatorial Elections, and the National Census.

**INDUSTRIALISATION**:

In the chairman's statements in the previous years, he reaffirmed that the company remains strongly committed to her current industrialization strategy, which has been reactivated over the last 5 years. Last year, he mentioned that the company entered into a programme with Delta Steel Company for the raw-casting of very essential mechanical parts. The venture is now operational with the mechanical parts being machined in our plant.

The development of local parts and components will receive a further boost when basic industries like the Petrochemical Industry at Eleme and the Ajaokuta Iron and Steel Mill are commissioned. The company is also exploiting other existing industrial and engineering facilities. It is pertinent to also state that since 1986, PAN has vigorously increased her in-plant local content development, despite a decrease in volume and less attractive industrial environment. The situation now is that any additional gain in local content development can only be obtained through high investment in equipment and specific toolings; the industry being highly capital intensive. We have remained

constantly in touch with the Federal Government in order to maintain the pressure and provide the necessary information to enable a more favourable environment to be created for the development of the automotive industry in Nigeria, as opposed to the importation of both new fully built-up cars and used ones. The Company will continue to pressurize the government to review the tariff and tax structures for better incentives, and for investments in the local manufacturing of car components, both out-plant and in-plant.

The chairman's statement mentioned, "I will keep you informed of developments on these vital issues on which the future survival of the Company rests".

**EXPORT**

The situation which was fully explained in the 1990 report with regard to the severe competition which the Company's product faced on the export market still persisted - the high tariff within the ECOWAS sub region and the smuggling of the Company's product across the border without duty payment. Despite these handicaps, the Company has continued to pursue strategies for new export market penetration while consolidating the existing ones.

The Company's sales efforts have, however, been limited by other operational difficulties which had impinged on the Company's production capacity in the plant, and which, during the year, left local customers partially satisfied.

**OPERATIONAL PERFORMANCE**

The Company recorded impressive sales achievements during the year under review. Turnover increased from N1.2 billion in 1990 to N2.1 billion in 1991, representing an increase of 71%. In unit terms, sales increased from 9,362 cars in 1990 to 13,307 cars

in 1991, a 42% unit increase. The effective demand resulted from both increased industrial activity and purchases from Federal Government Establishments, the Mass Transit Organisations, and the two registered political parties. However, profit before tax decreased from N25.5 million in 1990 to N10.2 million in 1991, a reduction of 60%.

The selling price of our products came under the invention of the Federal Government. The negative impact of the pricing policy and price freeze for the second half of the year, the cost of foreign exchange, and high financial charges drastically affected the profit performance of that period and, except for an excellent first half year performance, the Company would have had a disastrous 1991 result.

## DIVIDEND

The Company, having regard to the very low level of operating profit for the year, has recommended no payment of dividend for approval.

## FUTURE PROSPECTS

The state of the economy in 1992 will greatly depend on the world oil market and prevailing oil prices. For the Company, 1991 was a rather difficult year, considering some significant global developments, which affected its operations.

The regulation of interest rates and the floating rate of the Naira announced in March 1992 brought the exchange rate of the Naira from N10 per $1 to N18.5 per $1 and introduced a new cost structure for the Company's products. The future financing of the working capital of the company has resulted in an unprecedented level of financial cost and new financial requirements. Most importantly, the future of the Company is dependent on, among others, the current tariff structure that has virtually reduced the protection of locally assembled cars against fully built-up cars to 5%. Viewed against

the additional cost inherent in the local production environment, such as transportation cost from Lagos port to the factory in Kaduna, financing of the lead time between payment for purchase of dollars to the actual production and sale of a car (currently reduced from 6 to 4 months) and the impact of the local inflationary factors, the industry's protection had been drastically reduced. This contrasts with a 100% tariff differential in Malaysia or a total ban on importation of fully built-up vehicles in countries like Argentina, Brazil and India. The future of the Company depends greatly on a more favourable tariff differential that gives adequate protection to locally assembled cars against fully built-up vehicles.

## PRIVATIZATION

The privatization exercise, by which the Federal Government has agreed to sell her shares in the Company, is still on. Some unforeseen circumstances had delayed this exercise but the main objective is still on course. The Federal Government will now sell 20% of its share holding, thereby retaining a minimum of 15% in the Company.

## MANAGEMENT AND STAFF

Against the background of a rather difficult year, the Company once more expresses profound appreciation to management and staff for their loyalty to the Company. It demonstrates the solid strength of the industrial harmony in the company and it looks forward, with optimism, to the challenge of 1992 and the years beyond.

## 1992

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## INTERNATIONAL SCENE

The global economic recession of the past few years continued unabated throughout 1992, with marked sluggish and down turn economic growth, declines in industrial

production, inflation, worsened balance of payment and increased unemployment. In the United States, the economic down turn for the year played a decisive role in the American Presidential election, which saw the defeat of President George Bush in favour of Mr. Bill Clinton. Even Japan experienced the recession, while most European countries like Germany, Britain, Italy and France recorded declines in industrial outputs. The expectation of a European "Federation" with the ratification of the Maastricht Treaty was damped with no vote in Denmark. The level of material destruction and human carnage recorded in the continued balkanisation of the former Yugoslavia, especially in Bosnia, reached horrifying absurdity. (Annual Reports And Accounts; 1992:5).

The recession also affected adversely the world commodity prices. On the positive side however, dramatic developments were recorded in the global marketing strategies where inefficient centrally controlled economies were being replaced by dynamic open-market oriented systems resulting in international mergers and take over. This new development highlighted the fear that soon, the world would be dominated by few multinational moguls to the detriment, if not destruction of the economy third world countries.

The continent of Africa continued to be impoverished, with most countries engaged in finding solutions to political instability and economic structural reforms with their meager resources being depleted in long drawn civil strives of differing dimensions, like Sudan, Angola, Liberia, Somalia, Zaire and Togo. In South Africa, the initial euphoria of early return to democracy lost some momentum.

## THE DOMESTIC ENVIRONMENT

The operating environment for 1992 was a furious ride on a very bumpy terrain. The unfavourable international economic environment, especially the depressed oil market

together with domestic policy instability culminated in large fiscal imbalances, inflationary pressures, depressed exchange rate of the Naira and deteriorating balance of payment. Consequently, there was general slow down in real sector economic activities (manufacturing and agriculture). Through out 1992, the Central Bank of Nigeria was very active with its interventional instrument. The deregulation of the Foreign Exchange Market on the 5th of March, 1992, when the value of the Naira depreciated from N10.1 to $1 to N18.5 to $1, about 80% devaluation, heightened the inflationary spiral.

Its main objective was to wipe out the margin between the official rate of exchange of the Naira and that of the parallel market. Although the differential rates narrowed from about 80% at the beginning of March to about 5% by the end of June, by the end of 1992, the gap widened to 20%. Favourably, the CBN funded almost all the demands in Dollars of the banks during the bid sessions of 1992, with operating problems slipping from scarcity of Dollar to that of Naira.

The CBN was also active with the issuance of stabilization securities as a major instrument of monetary control with the objective of mopping up excess liquidity and firming up the value of the Naira. Unfortunately, the resultant haemorrhage of the funds from the banking system could not completely control the excess liquidity, probably due to the assumption that a greater percentage of the perceived excess liquidity was outside the bank vaults. Inter-bank and lending interest rates rose to unprecedented levels.

The overall budget deficit for 1992 was N43.8 billion. Inflation rose to 46% by December 1992, while the balance of payment recorded a deficit of US $371 million as compared to a surplus of US $861 million in 1991, with significant reduction of the external resources by the end of the year. This was largely attributed to the huge debt service obligations and execution of specific projects such as the Steel Complexes,

Aluminum Smelter Company, Export Processing Zone and Liquified Natural Gas (LNG). (Annual Report And Accounts; 1992).

By the end of the first half of 1992, the Federal Government took measures under Tariff Decree Nos.13 and 25, to alleviate the harsh impact of SAP and foreign exchange deregulation. Part of the package included granting tariff concessions and importation of fully built-up and second hand cars and reduction of customs duties on fully built-up cars, thereby depleting the protection hitherto extended to local car assemblers. This singular policy has introduced a new phenomenon in the automobile sector operation.

Despite some set backs, some remarkable achievements were recorded in 1992, such as the commissioning of phase 1 of the Ajaokuta Steel Complex, new completion of the Iron Ore Production Plant at Itakpe and the rail link between Itakpe and Ajaokuta, completion of the OSO Condensate Project and the Liquified Petroleum Gas Plant at Kaduna. The National Agricultural Land Development Authority (NALDA) programme took off in 25 states, with the establishment of between 30,000 to 50,000 hectares of farm complexes in each state. Also, various efforts are being made, both at local and national levels, to ensure that the Naira appreciates. It is pertinent to note that in spite of these efforts, certain undesirable macro-economic trends have made the achievement of this singular goal elusive. (Chairman's Statement; 1992).

This notwithstanding, the company's Gross Domestic Product (GDP) moved from N94.28 billion in 1991 to N98 billion in 1992, while Nigeria's external debt fell from US $33.36 billion in 1991 to US $27.56 billion in 1992, representing a reduction of US $5.80 billion. Worth mentioning also, is the fact that the company's local domestic debt has reduced considerably. The Company owes appreciation to both the States and Federal Governments for these noble achievements. The Company also appreciates

the patronage it has enjoyed from the State and Federal Governments and prays for continuity.

**INDUSTRIALIZATION**

The demand for more incentives to attract new investments for both local and foreign investors, low capacity utilization, and loss of markets share to imported cars have combined to slow down the initial inputs for local component development. However, the company's total commitment to increasing local content development, both in-plant and out-plant or on a joint venture basis has not been forestalled.

As reported last year in the Chairman's statement, the company continued to remain constantly in touch with the Federal Government in order to maintain the pressure and provide the necessary information to enable a more favourable environment be created for the development of automobile industry in Nigeria, and provide more favourable Investment incentives.

**EXPORT**

The structural difficulties expressed in previous years persisted through the year. The non-implementation of tariff incentives with the ECOWAS sub-region remained a barrier to improve trade. The company received encouraging contracts from some African Countries outside the ECOWAS, but the major handicap remained the non-existent trade agreement, which would have addressed the problem of freight, berthing facilities and rights and tariff. Unfortunately, however, our export drive was tempered by the company's domestic struggle to maintain market share at the face of severe and unfavourable competition from imported built-up cars.

## OPERATIONAL PERFORMANCE

Despite the overwhelming operating difficulties and handicaps, the company's operating performance was exemplary. Turnover improved from N2.1 billion in 1991 to N2.9 billion in 1992 representing an increase of 38%. Profit before tax increased from N10.2 million in 1991 to N50.7 million in 1992 representing an impressive 400% increase, and earnings per share of N4.06. Federal Government's patronage, together with improved industrial activities, were the major factors contributing to the improved performance.

Considering the prohibitive high level of financial charges, consequent on the unprecedented level of working capital, high cost of foreign exchange, and loss of market share to imported fully built-up cars, the result indicates a manifestation of the company's capacity to cope with the present global economic trend.

## DIVIDEND

The company having regard to the low level of the company's share capital to fund an operation of about N3 billion, high cost of funds, FOREX and its industrialization programme, has recommended for approval the capitalization of N90 million from the accumulated revenue reserve of N102, 589 million by the issue of bonus shares of additional 6 shares to N2 per share for every one share held. This was to enhance the capital base and the financial capability of the company.

The implication of the unprecedented increase in the level of working capital requirement consequent on the Naira devaluation with its attendant high interest volume necessitated this capitalization.

## FUTURE PROSPECTS

The retention of the tariff concessions granted by the government in the wake of the deregulation of the foreign exchange market has introduced a critical dimension in the operation and prospects of the company. Already, there are indications that part of the market share is being taken by imported built-up cars, especially those cars coming from East Asian countries. The enormous operating difficulties resulting from a N15 million-share capital financial manufacturing operation of N3 billion magnitudes cannot be over emphasized. The skew ness in the company's gearing ratio can only be traced to the suffocating high level of interest charges. The high level of working capital requirement consequent on the Naira depreciation means that the company urgently needs an injection of significant new capital/facilities to maintain current level of production. The company has for sometime now relied heavily on expensive short-term borrowings, as most banks are no longer interested in long-term lending. The Board and Management have therefore approached the Federal Government to provide a soft loan to cushion the high gearing handicap. In addition, the restructuring of the company's capital base with the injection of new capital is inevitable.

Given a stable political and economic environment, and the high calibre of the Board and Management, added to more enabling protection and incentives from the Government, the 1992 momentum should be maintained and the new challenges should lead to better opportunities.

## 1993

## GLOBAL ENVIRONMENT

The global recession, which had characterized the world economic environment during the last decade, showed the first sign of recovery for most of the industrialized nations, with economies of South East Asia, China, and the Indian sub-continent taking the lead. Industrial output for these countries showed significant improvement while the

American and European countries increased production and economic activities marginally. The protracted GATT agreement was concluded during the year. For most African countries, their economies deepened into further decline as they continued to struggle through the unrealized objectives of various Structural Adjustments with sustained incidences of famine.

On the political scene, the world witnessed increased human commotion and civil wars. While the ethnic cleansing in Bosnia abated towards the second half of the year due to sustained pressures from the United States of America and NATO forces, Africa witnessed civil calamities of genocidal proportions. The pathetic spate of human destruction in Rwanda declared as genocidal was witnessed helplessly world wide while other civil wars in Liberia, Sudan, Yemen, Angola, Somalia, and Mozambique continued unabated.

New-fascist activities exploded in Germany, while violent upsurges of nationalistic tendencies were reported in Italy and Spain.

On the American sub-continent, the political pressures and conflict in Haiti increased in its intensity. Happily, after a century of human indignity, the first free multi-racial election was fixed for early 1994 in South Africa, while the most significant happy event of 1993 was the golden handshake between Yitzhak Rabin of Israel and Yasser Arafat, heralding an era of peace in the Middle East.

## DOMESTIC ENVIRONMENT

The domestic economic cum political environment for the year 1993 were characterised by crises and instability. The annulment of the June 12 political election fuelled already charged political tension and nearly brought all socio economic

activities to a halt. The strikes called by the Labour Unions and the consequent incessant civil disturbances resulted in confusion and despair. The massive government budget deficit for the year of about N101 billion-fuelled uncontrolled expansion of money supply by the process of ways and means, a substantial part of which never went through the banking system. The speculative demand and dire shortage of foreign exchange resulted in significant decline in growth of the GDP. Price levels rose persistently through out the year with a highly volatile and distorted interest rate regime as well as fast depreciation of the Naira. Industrial capacity utilization fell dramatically. Some people moved from the big cities to their villages to escape anticipated political upheavals, thus disrupting economic activities. Some shops and factories were closed and valuable productive man-hours were lost. There were significant runs on the banks occasioned by many deposit withdrawals from the banks by the retreating populace.

The hyperinflation caused by these political uncertainties and social tension resulted in the need for higher working capital requirement in industries. (Annual Report And Accounts; 1993:4).

In addition, the crippling effect of the increased use of stabilization securities by the CBN and the need for many banks to pull their funds into CBN to back-up their foreign exchange requirement resulted in rapidly escalating interest rates and general shortage of credit from the banking system.

The combination of the events enunciated above caused industrial and agricultural organisations to suffer very low capacity utilization and decline in out-put through out the year. The GDP decreased from 3.6% in 1992 to 2.9% in 1993. There was a general lull in economic activities through out the year

## INDUSTRIALIZATION

Worsening operating environment dictated by continued favourable importation climate further reduced the product market share and dampened the necessary incentives to attract new investment, not only in the Automotive Industry, but also throughout the economy. Nonetheless, the Company still holds firmly to her total commitment to increase her in-plant and out-plant local content development. In this regard, the Company has an advance plan for the introduction of the Peugeot 306 model into the Nigerian market. The model has a relatively more favourable price disposition, with more advanced facilities and technology. The establishment by the Federal Government of the National Automotive Council and the launching of the National Automotive Policy within the year demonstrates conclusively the Federal Government's total commitment to the Automotive Industry in Nigeria.

The Company intends to work closely with the Council and it is hoped that this will create a very conducive atmosphere for the expansion of local content development in Nigeria as the council will now act as the ear of the Federal Government within the automotive industrial sub-sector.

## EXPORT

It is most essential to re-emphasize that the structural handicaps experienced in the previous years in the area of exports persisted in 1993. Despite this basic handicap the company maintained the initiative to export its products mainly in the West African sub-region.

Despite the non-implementation of the tariff incentives within the ECOWAS sub-region, the company has received encouraging contacts from Egypt and some other countries in Africa, especially on our 504 models. These initiatives can only be fruitful if our industrial production is maintained or increased with improved availability of foreign exchange to import the CKD.

It must be pointed out that there is the need for the current enabling environment in terms of effective protection against undue competition from imported built-up cars to be sustained and improved upon.

## OPERATING PERFORMANCE

The performance of the company in 1993 was totally dictated by the following factors:

1. The strangulating lack of foreign exchange.
2. Prohibitive interest rate.
3. Acute shortage of working capital.
4. Cost/price equation in hyper-inflationary economic condition.

Given the very diverse economic and socio-political climate in 1993 as enumerated earlier, the operating environment for 1993 was again a furious ride on a very bumpy terrain. It is satisfying that with the total dedication and diligence of the Management team and the support of the Board, the company sailed success fully into 1994. Turnover for 1993 increased from N2.87 billion in 1992 to N2.96 billion for the current operating year, an increase of 3%. In terms of product sales, the company sold a total of 7,818 cars. Profit before tax stood at N16.2 million against N50.7 million in 1992, representing a decline of 68%. This major decline in profit before tax was a result of astronomical interest rates charged by the banks. Interests and bank charges for 1993 stood at N245 million as against N222 million in 1992. In addition, the cost of importation of CKD, as expressed by the Naira equivalent of the Dollar, increased very significantly in

1993 compared to 1992. In fact, these two cost elements dwarfed all successful cost reduction exercises of the company in 1993.

## FUTURE PROSPECTS

The year 1994 started with high prospects for the company. The 1994 budget gave meaningful tariff protection on the company's product against fully built-up cars. In addition, the pegging of Naira rate at N22 to the Dollar and the interest rate at 21% promised a rosy picture for 1994. Unfortunately the combined effect of excess volume of Naira in circulation due to deficit financing of the 1994 Budget in combination with decreased volume of dollar allocated in the foreign exchange market combined to erase the initial euphoria. The cost push hyper inflation has continued through out 1994 and with the last price increase for your products dating as far back as October 1992, the initial, very favourable prospects for 1994 have been stultified. Demand for the products continued to increase throughout 1994 as a result of the favouable tariff protection and low prices. The prospect for 1994 will be decided by the quantum of foreign exchange available to the company and price/cost equation. Despite all available operational difficulties, the ability of the Management and Board to take effective actions to ensure the survival and future prospects of the company is assured.

## MANAGEMENT AND STAFF

1993 has been a very difficult year both for Management and Staff. The high burden of the strain in the economy was borne by the generality of the staff. Their composure and dedication to duty can only be described as exemplary.

**1994**

## GLOBAL ECONOMY

The global economy recovery and growth, which started towards the end of 1993, continued into 1994. The North America Free Trade Agreement (NAFTA), which included the United States of America, Canada and Mexico, was signed, while the new General Agreement on Tariffs and Trade (GATT) Treaty came into force. In Africa, most of the sub-regional trade agreements, like ECOWAS, made no significant progress in attaining their initial objectives. The African countries, with the exception of South Africa, attained negative and impressive economic records, with declining per capita income, worsening living standards resulting from heavy debt service burden, Structural Adjustment Programme, and unfavourable trade bilateral agreements. Towards the end of 1994, the Mexican economy experienced grave financial crises, which led to a steep devaluation of the Peso. The recession that followed caught international investors unawares and gravely damaged their belief that the emerging markets of the Latin America and South-East Asia held the promise for modern growth investments. This loss in confidence in the developing markets gravely imperiled the flow of new investments to these countries and, worse still, to most African countries.

The dismantling of Apartheid in South Africa and the attendant democratization of the political systems rekindled confidence; consequently new investments are currently flowing impressively into the region.

During the 1994 business year, the East Asian markets continued to sustain superior rates of economic growth, while the Latin American markets were marked by much more volatility. On the political arena, the genocidal civil war in Rwanda eased towards the end of the year. Other civil wars in Liberia, Sudan, Angola, and Mozambique, continued throughout 1994, while on the European scene, the carnage in Bosnia raged

on throughout the year. The American military intervention in Haiti ended years of military dictatorship and ushered in democracy in that country.

## DOMESTIC ENVIRONMENT

The disruption of economic activities started in 1993 by the annulment of the June 12 political election abated. This metamorphosed into grave political instability in the latter part of 1994. The national economic policies, though well motivated, were largely negative in direction and failed to attain their original objectives.

The "U" turn in the monetary and fiscal policies which reverse the deregulated economy to a regulated one, was characterized by the pegging of the exchange rate at N22 to $1 and the maximum lending interest rate of 21%. This neither bridged the difference between the official rate and the parallel market rates nor balanced the macro-economic instability. The unofficial devaluation of the Naira worsened, while the inflation for the year heightened to, by official estimate, 70% as compared to 57.2% in 1993. At a stage, the exchange rate topped at N100 to a dollar on the parallel market. The economy, therefore, witnessed a lot of distortions in the demand patterns for foreign exchange with panic and stampeded demand curves. The insufficiency and lack of available foreign exchange at official rate to go round further aggravated the level of inflation. (Annual Reports and Accounts; 1994:3).

To the ugly words of death and debt, the word "Distressed" finally entrenched itself in the national vocabulary and gradually completed the final link in the chain of human misery. Over 37 banks were declared distressed during 1994 with billions of Naira of

depositors funds flushed down the drains. Four banks were liquidated, while hundreds of Finance Companies and Mortgage banks wound up voluntarily.

The year also witnessed high cost-push inflation nationwide. It also witnessed unprecedented importation of fully built-up cars and used cars, due to favourable tariff dispositions and unfavourable protection against locally assembled cars. These conditions epitomized the harsh and uncertain climate under which the company operated in 1994.

**INDUSTRIALISATION**

Conditions for new investments in the economy as a whole continued to be dampened by an unfavourable and un-attractive enabling environment. The worsening operating environment, as reported in the Chairman's statement of 1993, continued unabated throughout 1994, with future loss of new market share to the imported fully built-up car market, which continued to receive more favourable policy incentives.

Nonetheless, the Company's confidence in the ultimate economic recovery of the country is unshaken. Consequently, despite unhealthy investment environment, the company is in the process of establishing two in-house projects within the factory.
The first project is a Press Shop, which involves the installation of a fleet of machines, and heavy presses to stamp 504 body parts such as fenders, doors, bonnets, chassis, frame, etc. The factory production would be as capital goods and also as spares for the secondary markets. It is hoped that these presses will use the Ajaokuta flat steel sheets. The projected investment outlay is estimated to be slightly above one billion Naira and the company is already discussing with the Federal Government for financial assistance in sourcing the capital.

The second project is the Machining Project. This project entails putting in place a complete Machine Shop to manufacture engine parts such as cylinder blocks, crankshafts, pistons, rocker arms, connecting rods, cylinder heads, etc. Delta Steel at Aladja and Nigeria Machine Tools at Oshogbo are expected to supply the relevant raw ferrous castings , while the Aluminum Smelter Company at Ikot Abassi in Akwa Ibom State would supply the aluminum castings.

The company is currently discussing these projects with government officials, and their implementation would assist the company to attain the 65% local content development mark.

According to the Chairman, the company would launch the Peugeot 306 model in November, 1995, with significant benefits which include up-dating the company's production technology, improving the company's product appeal, satisfying the company's product expectations and enhancing greatly the company's export potentials.

## EXPORT

As reported in 1993 the structural handicaps experienced during the last few years in the areas of export again persisted throughout 1994. Equally, the non-implementation of the tariff concession within the ECOWAS sub-region restrained further market penetration. Against all these domestic economic constraints, the company increased its export drive and made some inroad outside the West African sub-region.

## OPERATING PERFORMANCE

Against the background of deep economic recession, unstable political situation, insufficient foreign exchange availability, and severe competition by imported fully built-

up cars, the company increased its turnover from N2.96 billion in 1993 to N3.3 billion in 1994. This represented an increase of 11.5%. The gross profit before tax rose from N16.15 million in 1993 to N35.8 million in 1994. Profit after tax rose also from N9.5 million in 1993 to N21.1 million in 1994. This impressive result was the cumulative effect of the continued effort of the management and staff of the company to ensure its continued growth and viability. Series of sacrifices, belt tightening, and courage have been brought to bear on the operations of the company. They all deserve to be congratulated given the harsh economic and political realities of the operating environment.

**FUTURE PROSPECTS**

Prospects for the company indicated that 1995 would prove to be one of the most difficult years. Against the background of hyper-cost push inflation, stringent credit squeeze and control policies by government as against the hitherto familiar massive government difficult financing, unit sales have seriously decreased. The liquidity crunch nationwide has drastically reduced effective demand, and installed capacity utilization has been at its lowest ebb. Fortunately and encouragingly, the company has reacquired a significant share of the passenger car market, lost in previous years due to unfavourable import policies. The 1995 budget has introduced meaningful tariff protection for locally made cars. (Annual Report and Accounts; 1994:4).

The present strangulating liquidity squeeze has affected all economic activities in the nation. The need to maintain the belt tightening policy and avoid over-heating of the economy, plus the foreseeable elements of political stability would usher in sustainable economic growth, which the company is confident to exploit. With traditional, but seasonal, high effective product demand in the third quarter of the year, the company is expected to sail through the current rough economic waters. The recent

announcement of Transitional Programme to Democratic Civilian Rule has injected political confidence into the economy and would encourage and strengthen economic activities. (Chairman's statement; 1994:5).

*CHAPTER FIVE*

# CONCLUSION AND RECOMMENDATION

## 5.1 OVERVIEW OF THE CHAPTER

This chapter is the concluding chapter of this study. It is designed to draw conclusions from the findings, make recommendations, and outline the limitations of the research.

## 5.2 CONCLUSION

This study was aimed at evaluating the performance of the car-assembling plant through the use of Financial Ratios Analysis. The study covers a period of ten years from 1984 to 1994.

The Univariate Analysis revealed that the company faced hyper-cost push inflation, stringent credit squeeze, and control policies by government, political and socio-economic instabilities, and financial difficulties during the period reviewed.

The financial difficulties the company went through during the period were both of current and long-term nature.

The ratios calculated in the Analysis give a reasonably good idea of the company's main weaknesses. It is the process of identifying the financial strength and weakness of a business.

A single ratio however, does not on its own give a meaningful result, but how to be compared against a standard (either within or outside the business). If the ratios are compared with a standard within the business, this may take the form of "Trend Analysis" i.e. comparison of the firm's performance over the years. "Time Series Analysis", and if compared with other firms in the same industry, it is usually referred to as "Cross Sectional Approach".

The analysis in this study showed excessive fixed assets, slow-moving incentives, under-trading and operating losses, etc. The causes of these financial difficulties were difficult to exhaust and diagnose because of un-collectable receivable and diversified funds to miscellaneous use. Besides, enough data is not available for a full diagnosis.

On the basis of this study, with respect to the information in Appendix B, it will be observed that some ratios are good evaluators of business performance and they are as follows:

1. Fixed Assets Turnover.

2. Sales to Working Capital.

3. Gross Profit Margin.

4. Net Profit Margin.

5. Stock Turnover.

6. Interest Cover Ratio.

## 5.3 RECOMMENDATIONS

Based on the findings of the study, we wish to recommend the following in order to enhance efficient evaluation of performance and better risk management in the Company.

### 1. MANAGING BUSINESS RISK

The stages of development of a risk management process should be broken down as follows:

a) Awareness that risk is important, not because of its origin, but because of its potential effect on the business.

b) Development of a strategy and a set of policies under which risk can be managed.

c) Creation of a reporting framework for the management of risk, including responsibilities and reporting lines.

d) Analysis of the risks faced by the company, in terms of their financial effect and the likelihood of losses.

e) Development of cost effective techniques to mitigate losses.

f) Monitoring of the Management Process and implementation of improvement in that process.

2 To enable creditors and investors identify and quantify risks, while also quantifying the management's ability to handle the risks, the following ratios are recommended:

a) Total Assets to Working Capital (TA/WC).

b) Fixed Assets to Total Assets (FA/TA).

c) Average Total Assets to Sales (ATA/S).

d) Total Debt to Equity (TD/E).

e) Average Debtors to Sales (AD/S).

f) Total Debt to Cash flow (TD/CF).

g) Sales to Cash Flow (S/CF).

3. For efficient financial analysis, the company should improve on the quality and quantity of information generated by the accounting system and should attempt to make further enquiry to the following questions:

a) Is the business generating enough profits?

b) Is it able to meet its various obligations, so as to continue in business?

c) Is it using all the assets at its disposal effectively and efficiently?

d) Is the business sourcing long-term loans to enable it finances its expansion programme?

e) Is it paying dividends from loans?

f) Can it finance routine payments from ordinary operations?

## 5.4 LIMITATION OF THE STUDY

Most researchers on Ratio Analysis like Altman, Edward B. Denkin, and Beaver based their research on a large number of firms, but this study will be based on one company due to some reasons:

a) There are few firms in Nigeria with the same line of business and the same capacity.
b) There are suspicions about any request for their balance sheets and income statement and in most cases unwillingness to release their financial statements is encountered.

The period of 10 years covered is fairly short. A 30 year period would have been better because the longer the trend, the better the strength of prediction.
Ratios are constructed from accounting data, and accounting data are subject to different interpretations and even to manipulation.

It is not easy to decide on the proper basis for comparison. Ratios of a company have meaning only when they are compared with some standards. Usually, it is recommended that ratios should be compared with industry averages, but the industry averages are not easily available. Further, there is nothing sacred about the industry average figures - after all, any management worth its salt will try to be better than average.

Ratios by themselves cannot describe a dynamic system. While flow variables used in ratios analysis are defined over a fixed period, they lack explicit dependency upon time. As a result, ratios are limited to a comparative static analysis, but the

performance of a firm is a dynamic process showing the proper turning of cash receipts and disbursement.

Current ratios are those current assets which, when analysed, can be manipulated through a practice known as window dressing. This involves the temporary payment of current debts just prior to the financial statement data resulting in an improvement of the current ratios.

Ratios provide information about the current status of the firm, but they do not provide information about alternative strategies to be used and the intervening economic conditions confronting management and investors.
Some information in the published accounts might not lend itself readily to ratio analysis but may still be an indication of financial difficulties e.g.:

i.) Very large increases in intangible fixed assets.

i.i.) A worsening net liquid funds position as shown by the funds flow statements.

i.i.i.) Very large contingent liabilities.

iv.) Important post balance sheet events.

Published information about environmental or external matters is one of the external factors, which cloud the analysis of the overall performance of a firm. There may also be published information about matters that will have a direct influence on a company's future, although the connection will have to be made and may not be obvious.

Examples are:

i.) New legislations e.g. on corporation and local raw materials usage which affects company's main products.

i.i.) International events, e.g political disagreements with a foreign country, leading to a restriction on bilateral trade between the countries. The foreign country concerned might be a major supplier of a company's product.

i.i.i.) New and better products being launched on to the market by a competitor.

iv.) A big change in Foreign Exchange rates, which might affect a highly geared company seriously.

v.) A big change in Foreign Exchange rates, which might affect a major importer or exporter seriously.

The study was thus carried out within the framework of these limitations.

## ***APPENDIX A***

DEFINITION OF RELEVANT FINANCIAL RATIOS

- **A. LIQUIDITY RATIOS**

| | | | |
|---|---|---|---|
| 1. | Quick (acid) Ratio | = | Current Assets - Stocks / Current Liabilities |
| 2. | Current Ratio | = | Current Assets / Current Liabilities |
| 3. | Sales to Working Capital | = | Sales: (Current Assets-Current Liabilities) |

**B. LEVERAGE RATIOS**

| | | | |
|---|---|---|---|
| 4. | Debt - Equity (Gearing) | = | Term loans + Fixed Dividend Capital / Ordinary shareholders' funds |
| 5. | Debt-capital Employed | = | Term Loans / Capital employed (total net Assets) |
| 6. | Interest Cover Ratio | = | Profit Before Tax + Interest / Interest charges. |

**C. ACTIVITY RATIOS**

| | | | |
|---|---|---|---|
| 7. | Average Collection Period | = | Debtors / Annual Credit sales x 365 days |
| 8. | Average Payment Period | = | Creditors / Annual Credit Purchases x 365 days |
| 9. | Debtors Turnover | = | Credit Sales / Debtors |
| 10. | Stock Turnover | = | Cost of Goods Sold / Average Stock Held |
| 11. | Fixed Assets Turnover | = | Sales / Fixed Assets |

12. Working Capital to Total Assets = $\frac{\text{Working Capital}}{\text{Total Assets}}$

13. Working Capital to Sales = $\frac{\text{Current Assets - Current Liabilities}}{\text{Sales}}$

## D. PROFITABILITY RATIOS

14. Return on Capital Employed = $\frac{\text{Profit Before Tax}}{\text{Capital employed}}$

15. Net Profit Margin = $\frac{\text{Profit Before Tax}}{\text{Sales}}$

16. Gross Profit Margin = $\frac{\text{Gross Profit}}{\text{Sales}}$

17. Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Sales}}$

## E. INVESTORS (STOCK EXCHANGE) RATIOS

18. Earnings per Share (EPS) = $\frac{\text{Earnings}}{\text{No. of Shares}}$

19. Price-Earnings (P/E) Ratio = $\frac{\text{Market price per share}}{\text{Earning per share}}$

20. Earnings Yield = $\frac{\text{Earnings per share x 100}}{\text{Market price per share}}$

21. Dividends Yield = $\frac{\text{Dividend per share x 100}}{\text{Market price per share}}$

22. Dividend Cover = $\frac{\text{Earnings per share}}{\text{Dividend per share}}$

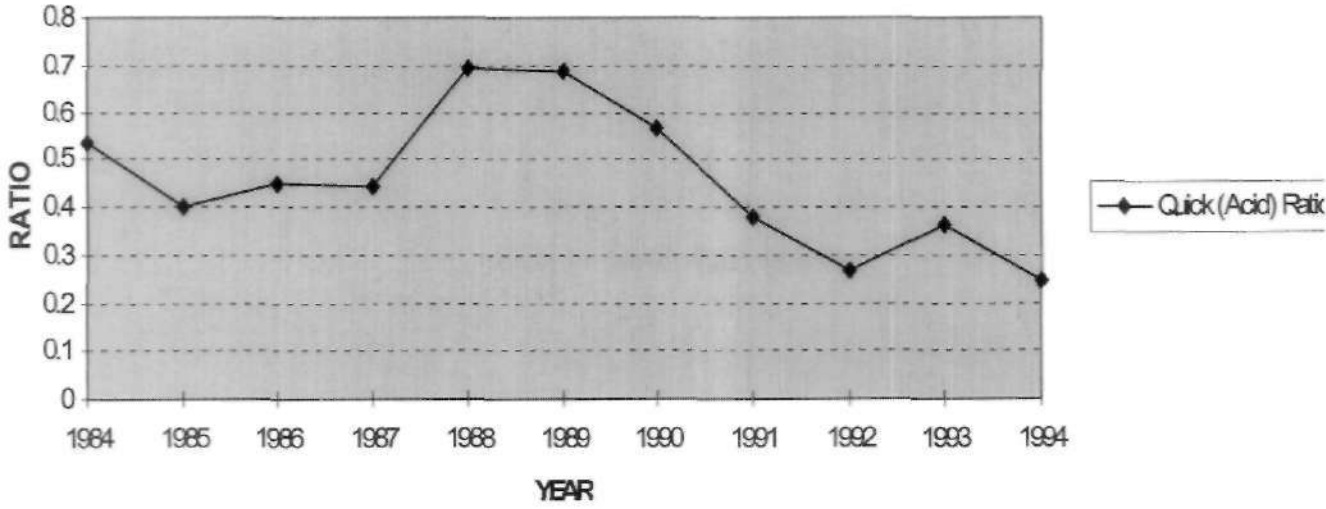
# APPENDIX B

FINANCIAL RATIOS OF PEUGEOT AUTOMOBILE NIGERIA PLC.

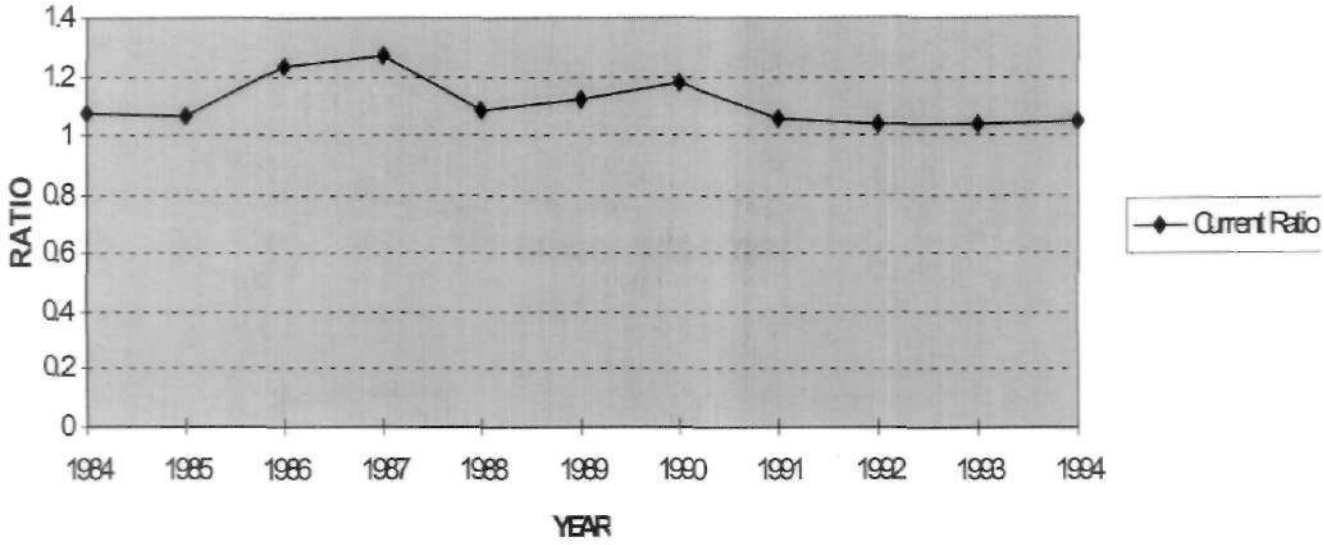
| RATIOS | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Quick (Acid) Ratio | 0.532 | 0.398 | 0.45 | 0.441 | 0.693 | 0.689 | 0.563 | 0.377 | 0.268 | 0.363 | 0.246 |
| Current Ratio | 1.071 | 1.069 | 1.235 | 1.269 | 1.089 | 1.119 | 1.174 | 1.057 | 1.037 | 1.034 | 1.05 |
| Sales to Working Capital | 24.34 | 18.89 | 4.895 | 3.674 | 8.779 | 7.423 | 12.72 | 41.17 | 52.25 | 72.92 | 48.18 |
| Debt Equity (Gearing) | 0.054 | 0.034 | 0.014 | 0.009 | 0.13 | 0.114 | 0.519 | 0.071 | 0.04 | 0.017 | 0.006 |
| Debt Capital Employed | 0.056 | 0.026 | 0.006 | 0.005 | 0.003 | 0.048 | 0.298 | 0.047 | 0.029 | 0.013 | 0.004 |
| Interest Cover Ratio | 1.745 | 1.782 | 1.094 | 1.164 | 1.308 | 1.376 | 1.398 | 1.089 | 1.228 | 1.066 | 1.098 |
| Average Collection Period | 975 | 858 | 8337 | 1981 | 2371 | 507 | 1082 | 1625 | 855 | 659 | 678 |
| Average Payment Period | 565 | 1138 | 501 | 367 | 5328 | 650 | 367 | 398 | 370 | 367 | 367 |
| Debtors Turnover | 0.374 | 0.426 | 0.044 | 0.184 | 0.154 | 0.72 | 0.337 | 0.225 | 0.427 | 0.554 | 0.538 |
| Fixed Assets Turnover | 11.5 | 11.54 | 4.477 | 2.845 | 6.553 | 8.056 | 14.51 | 6.657 | 80886 | 9.177 | 11.34 |
| Working Capital to Total Assets | 0.321 | 0.379 | 0.478 | 0.436 | 0.427 | 0.525 | 0.533 | 0.138 | 0.144 | 0.112 | 0.19 |
| Working Capital to Sales | 0.041 | 0.053 | 0.204 | 0.272 | 0.114 | 0.137 | 0.079 | 0.024 | 0.019 | 0.014 | 0.021 |
| Return on Capital Employed | 0.243 | 0.172 | 0.006 | 0.015 | 0.066 | 0.087 | 0.138 | 0.027 | 0.133 | 0.044 | 0.01 |
| Net Profit Margin | 0.057 | 0.044 | 0.004 | 0.015 | 0.018 | 0.023 | 0.02 | 0.005 | 0.018 | 0.005 | 0.011 |
| Operating Ratio | 0.857 | 0.865 | 0.996 | 0.985 | 0.933 | 0.933 | 0.931 | 0.949 | 0.906 | 0.913 | 0.879 |
| Earnings per Share | 2.12 | 1.51 | 0.16 | 0.34 | 0.87 | 1.27 | 2.04 | 0.81 | 4.06 | 0.18 | 0.4 |

SOURCE: Annual Report and Accounts 1984 - 1994

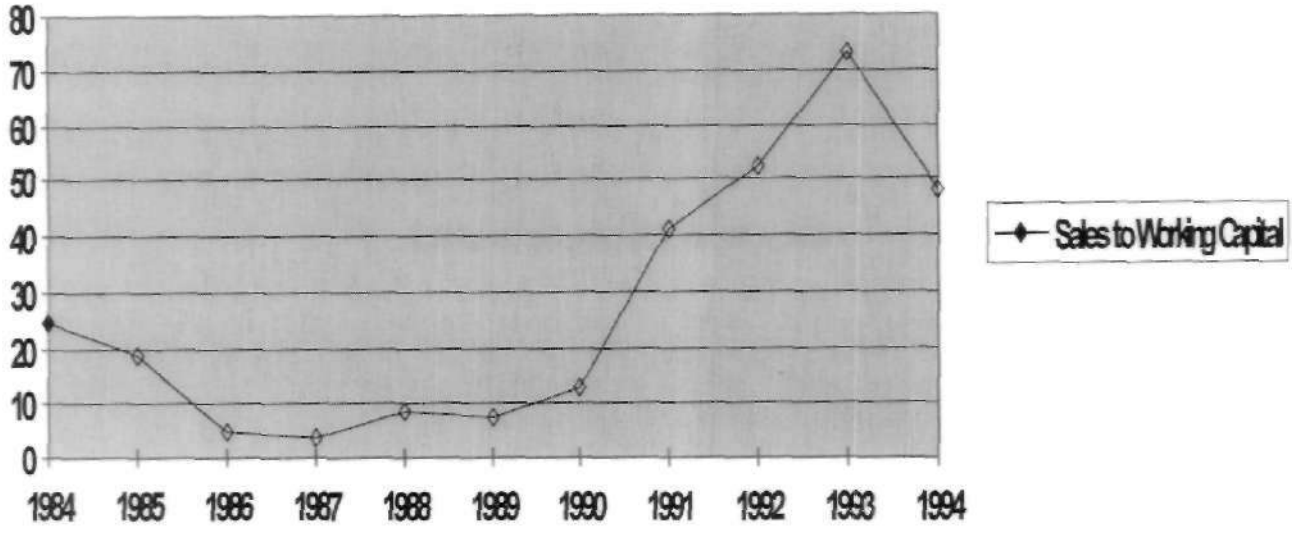
PAN Ltd. Quick (Acid) Ratio



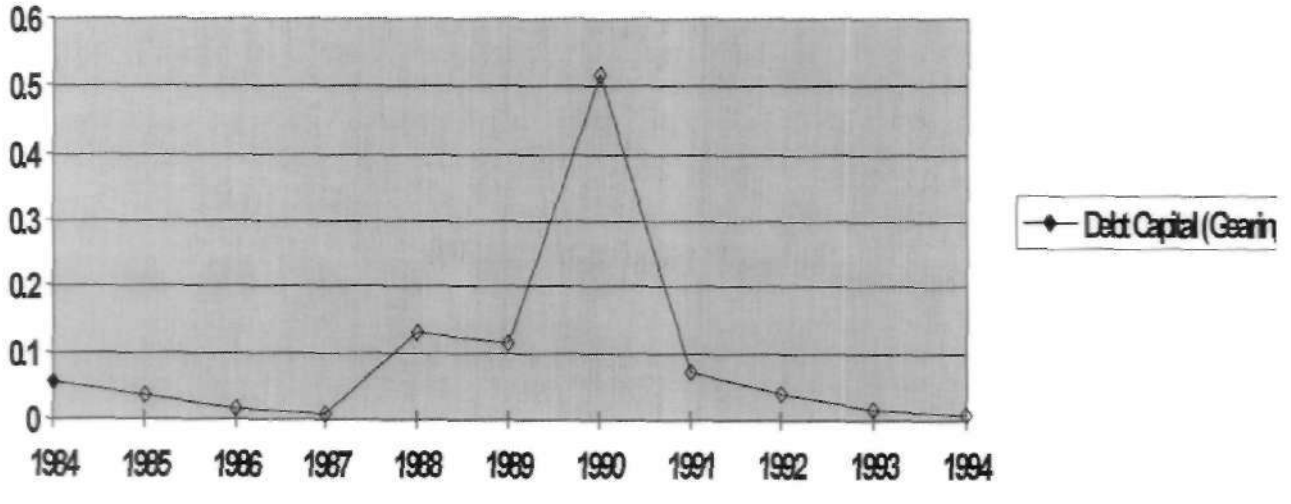

PAN Ltd. Current Ratio



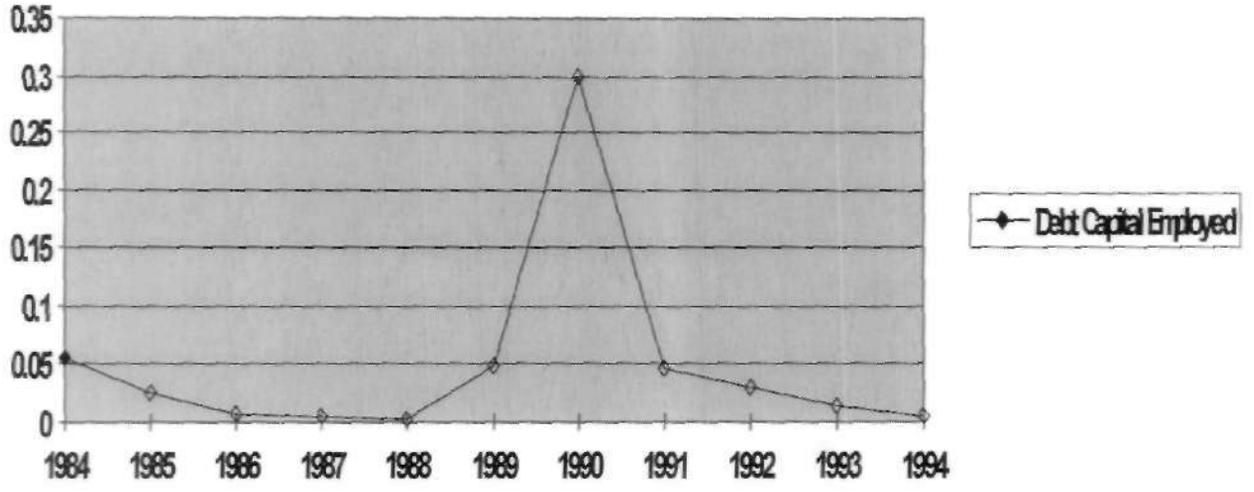
PAN Ltd. Sales to Working Capital



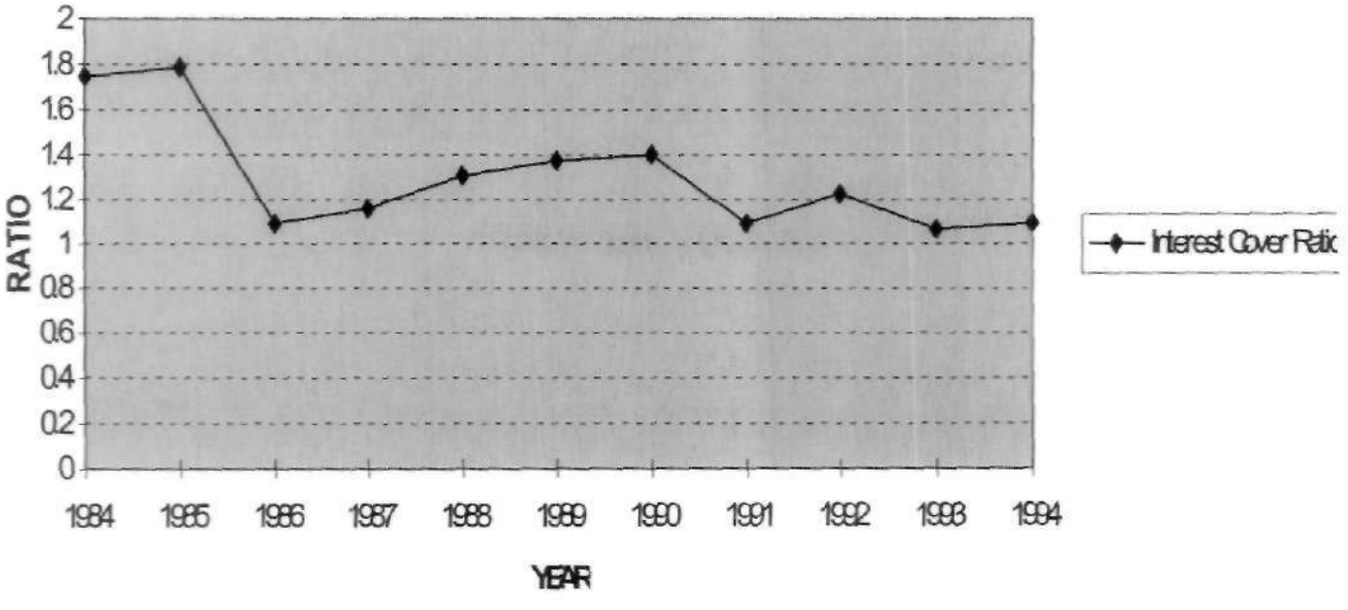

PAN Ltd. Debit Capital (Gearing)



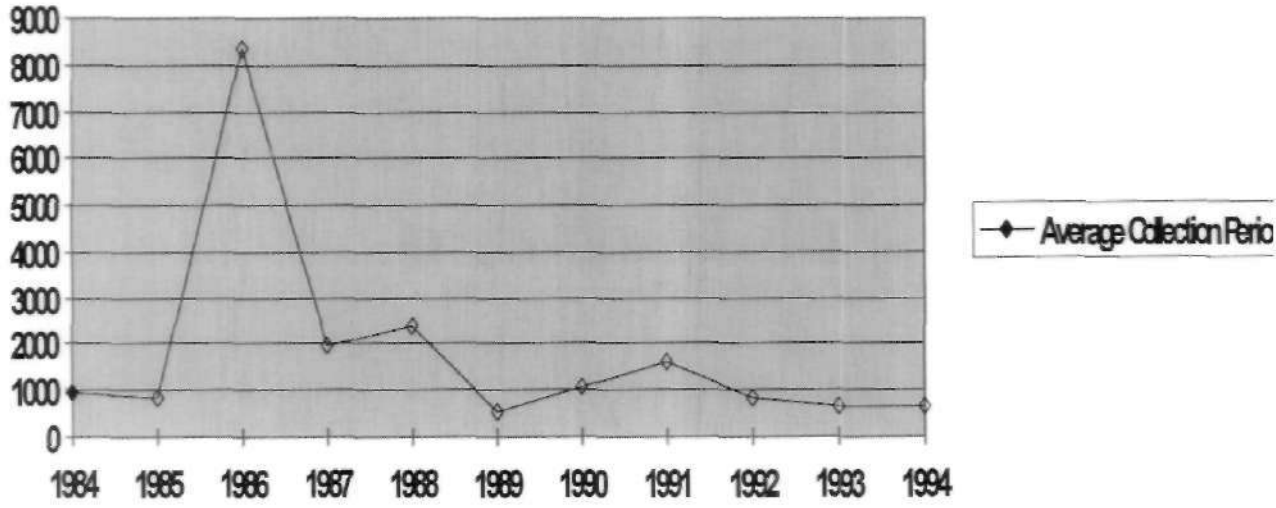
PAN Ltd. Debit - Capital Employed



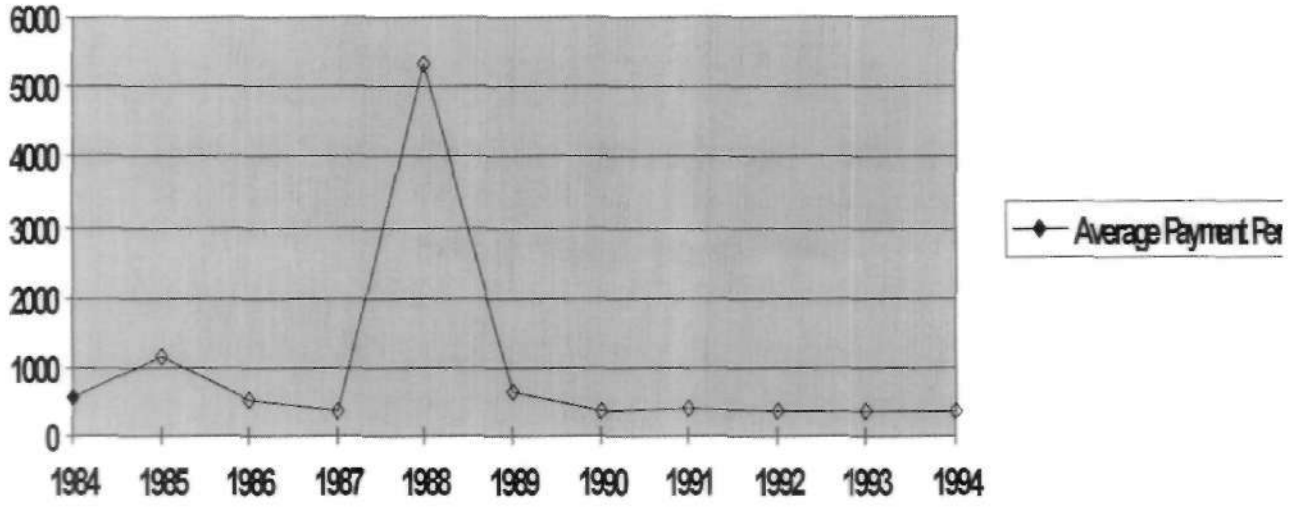

PAN Ltd. Interest Cover Ratio



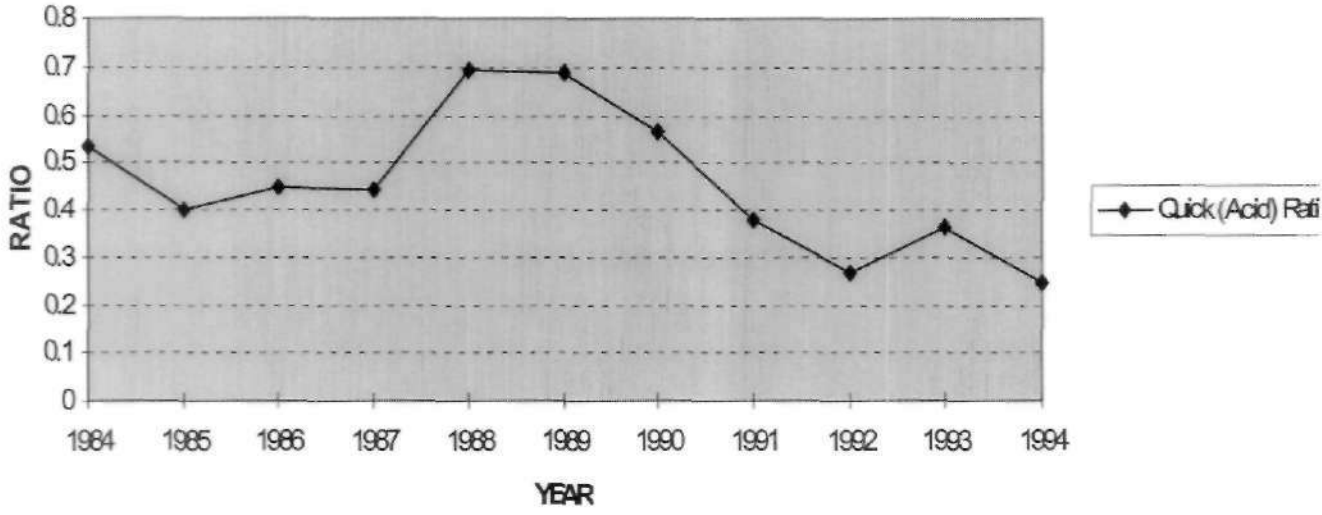
PAN Ltd. Average Collection Period



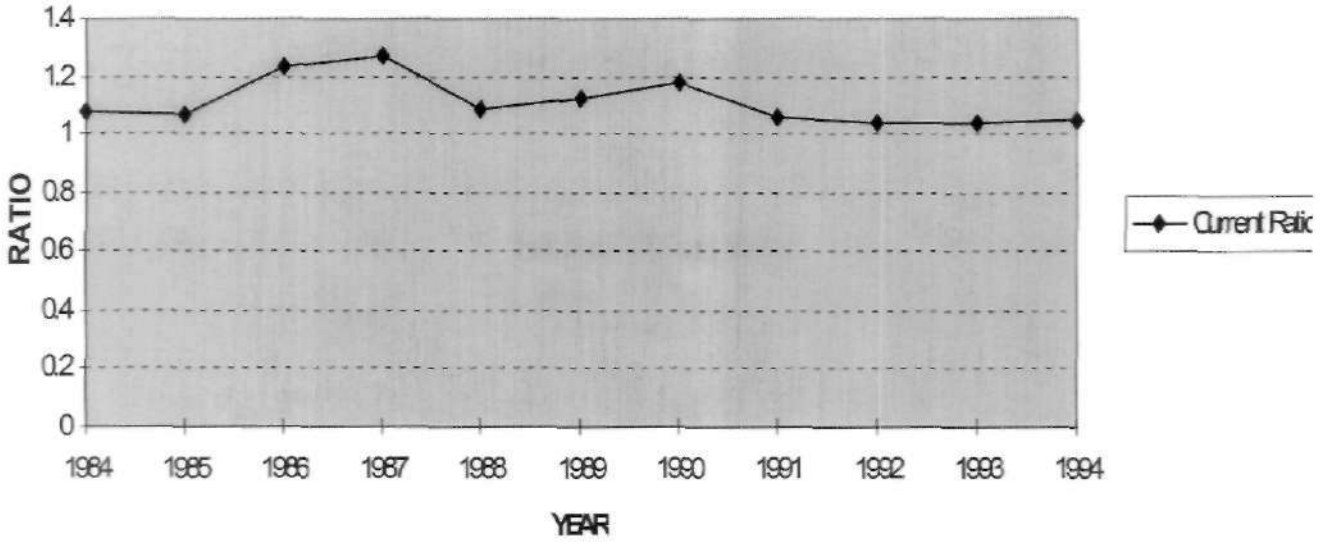

PAN Ltd. Average Payment Period

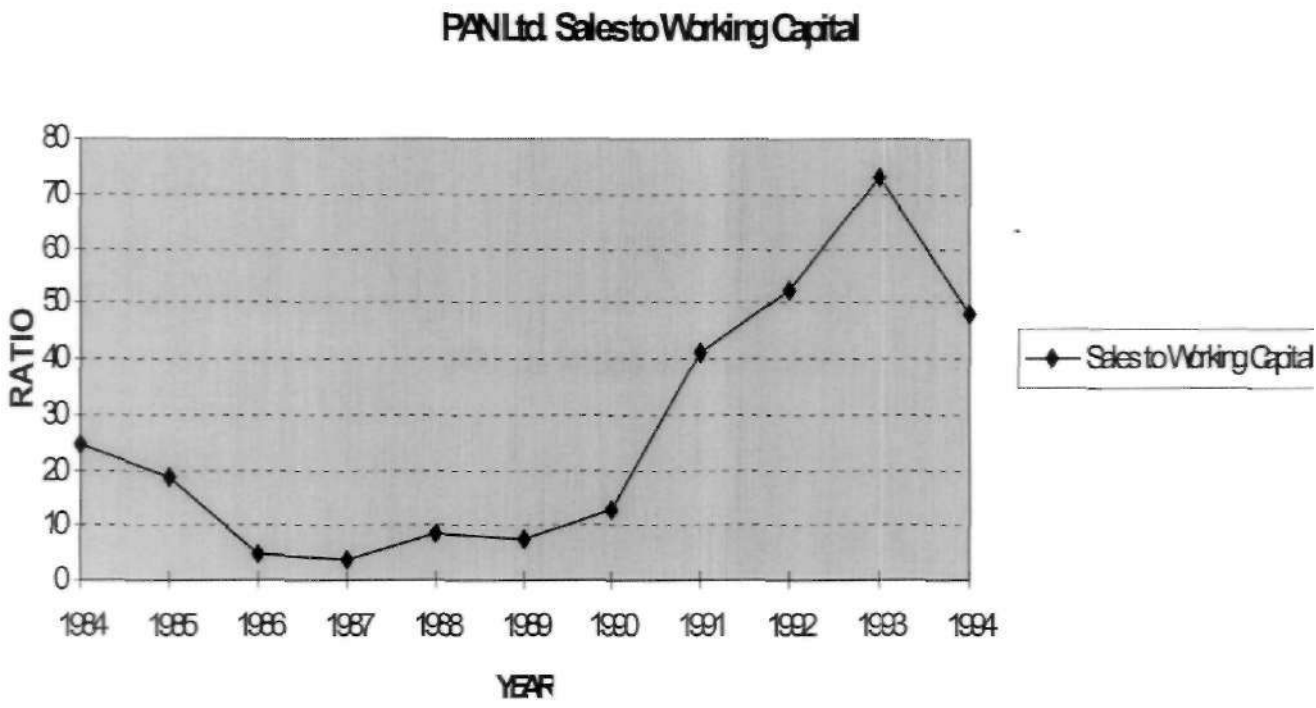


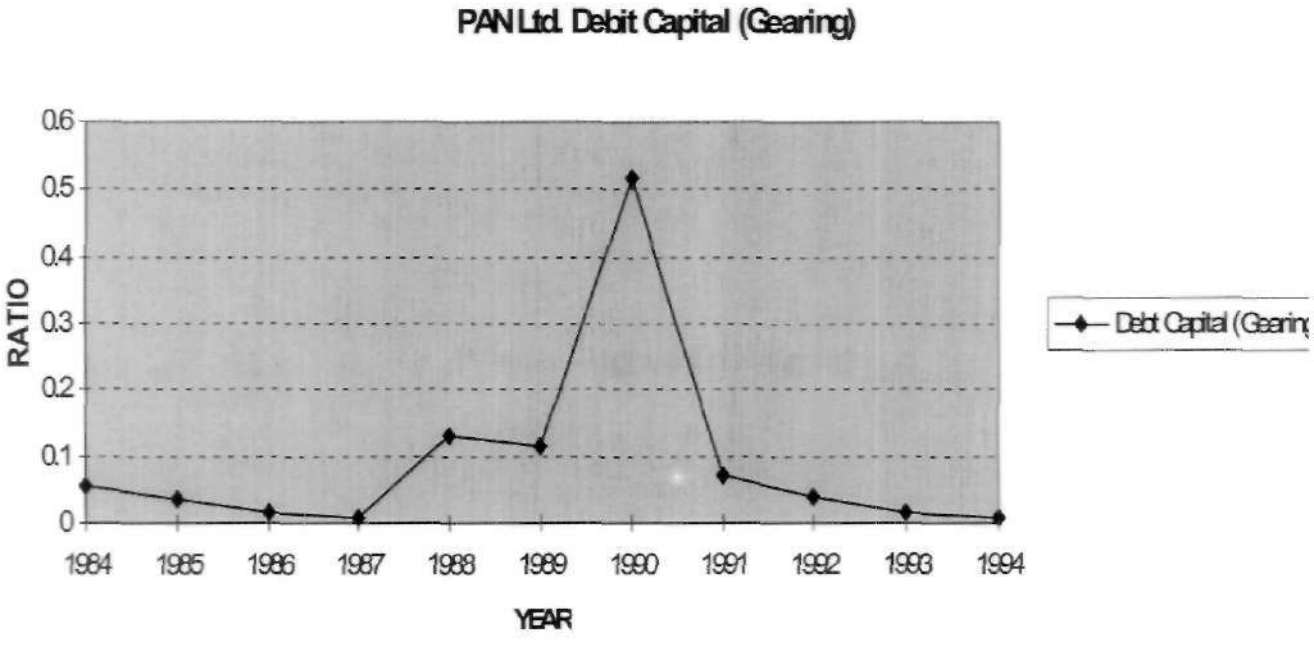
PAN Ltd. Quick (Acid) Ratio




PAN Ltd. Current Ratio

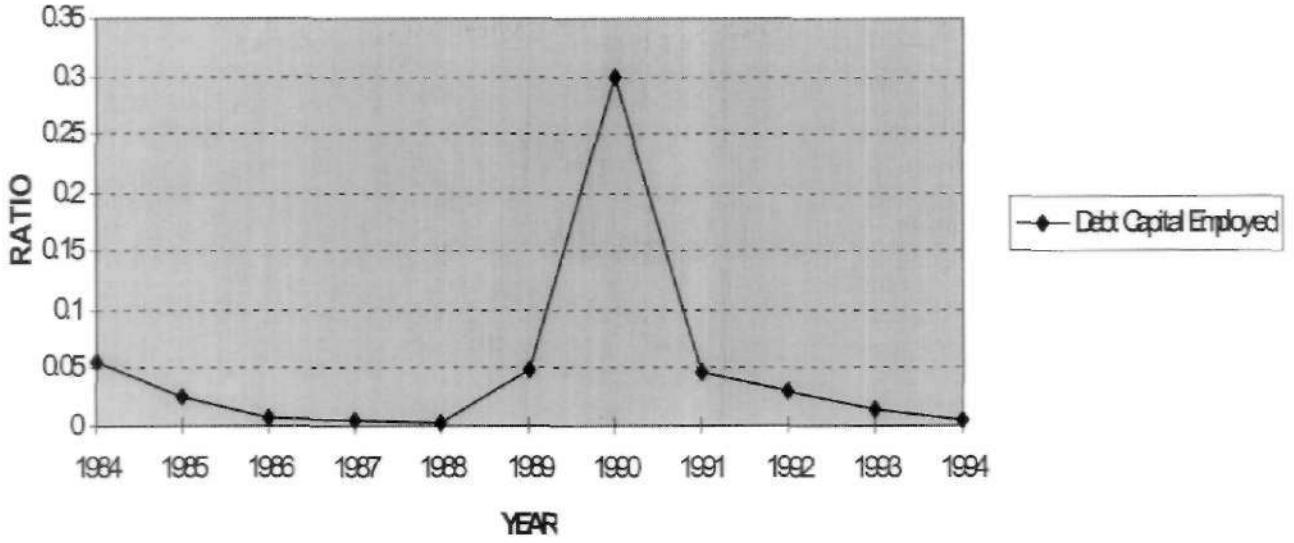




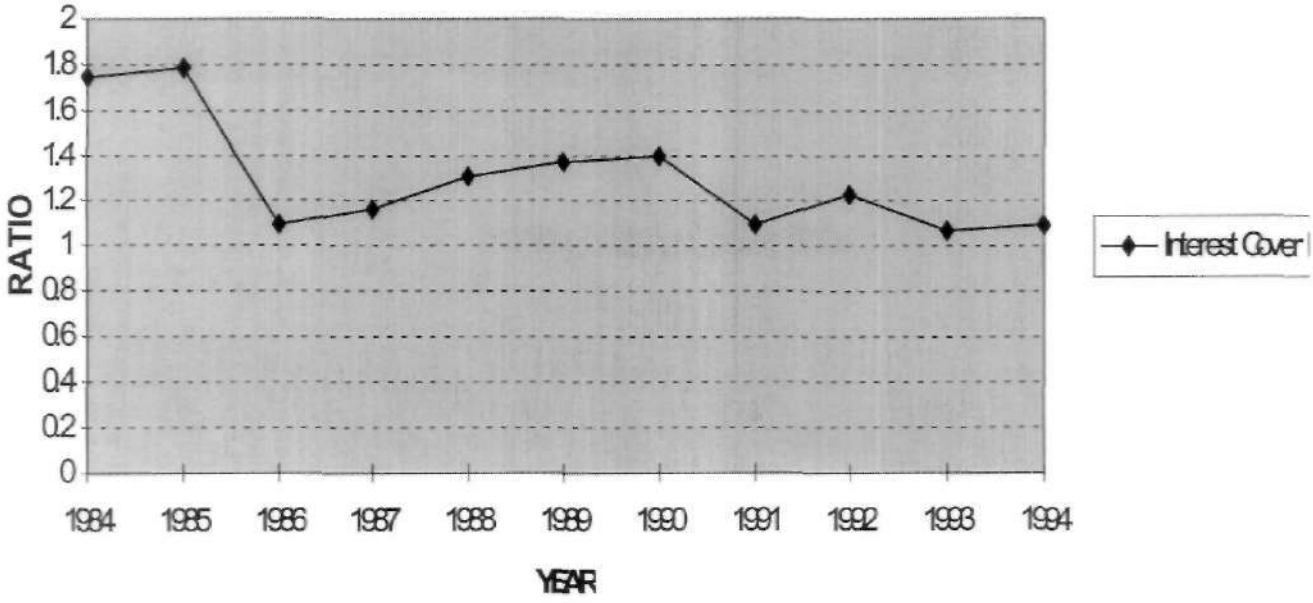



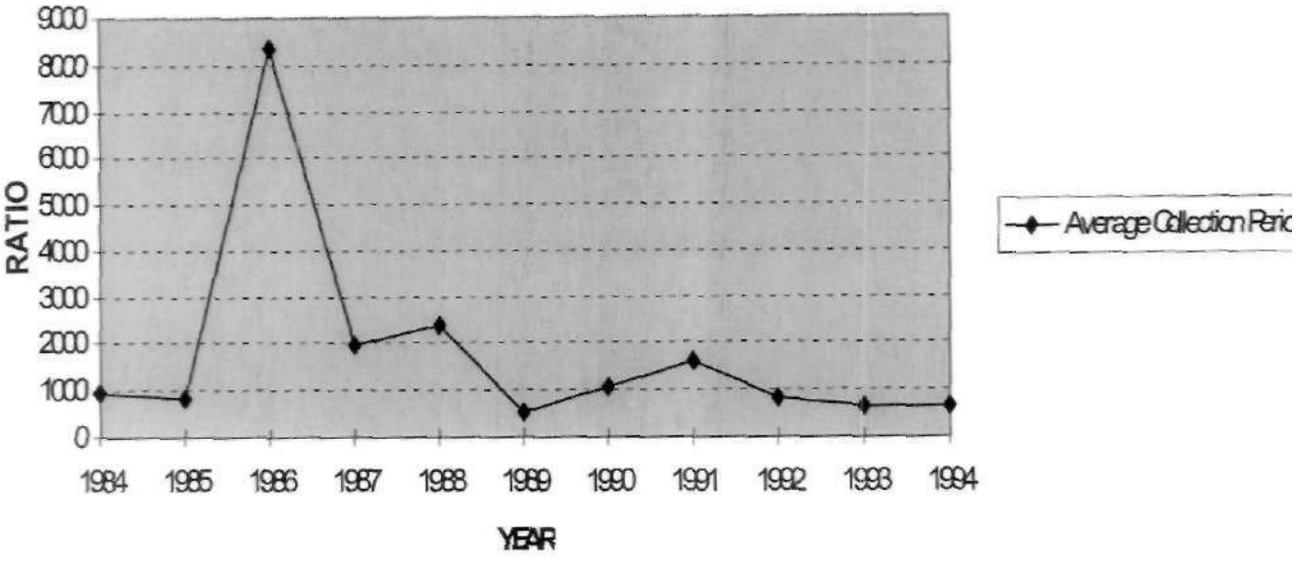

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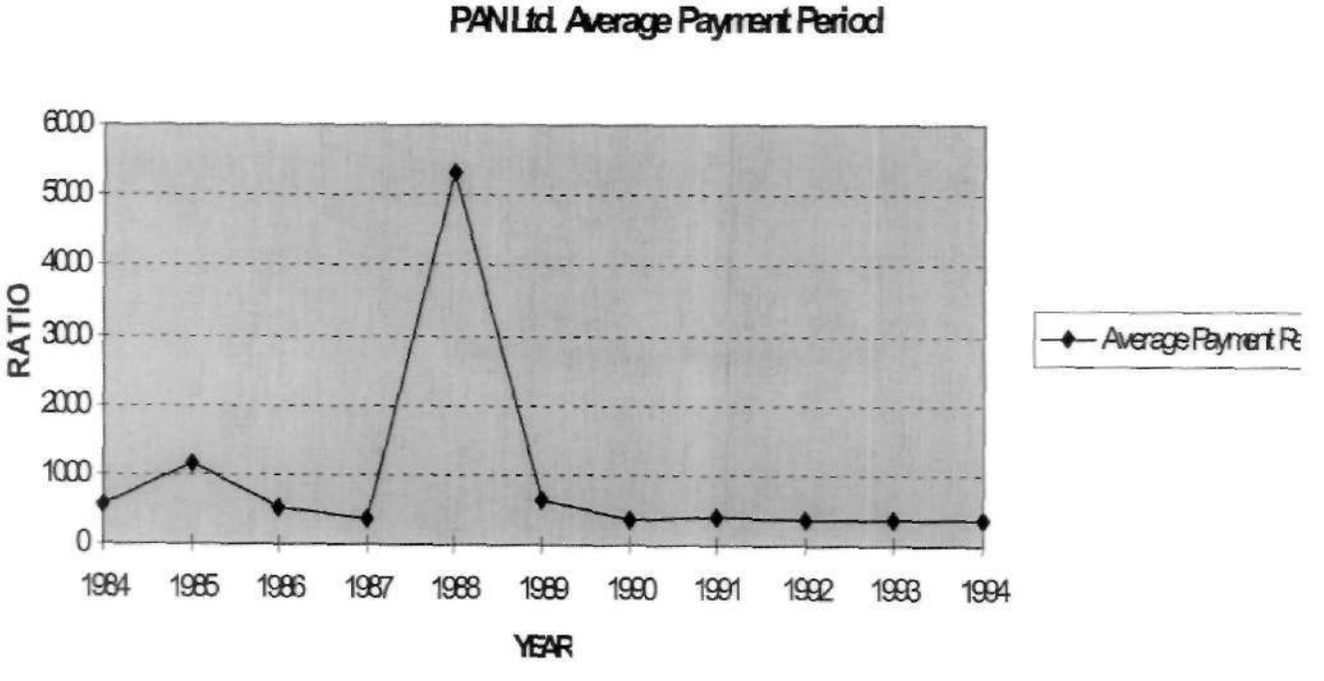
PAN Ltd. Debit - Capital Employed

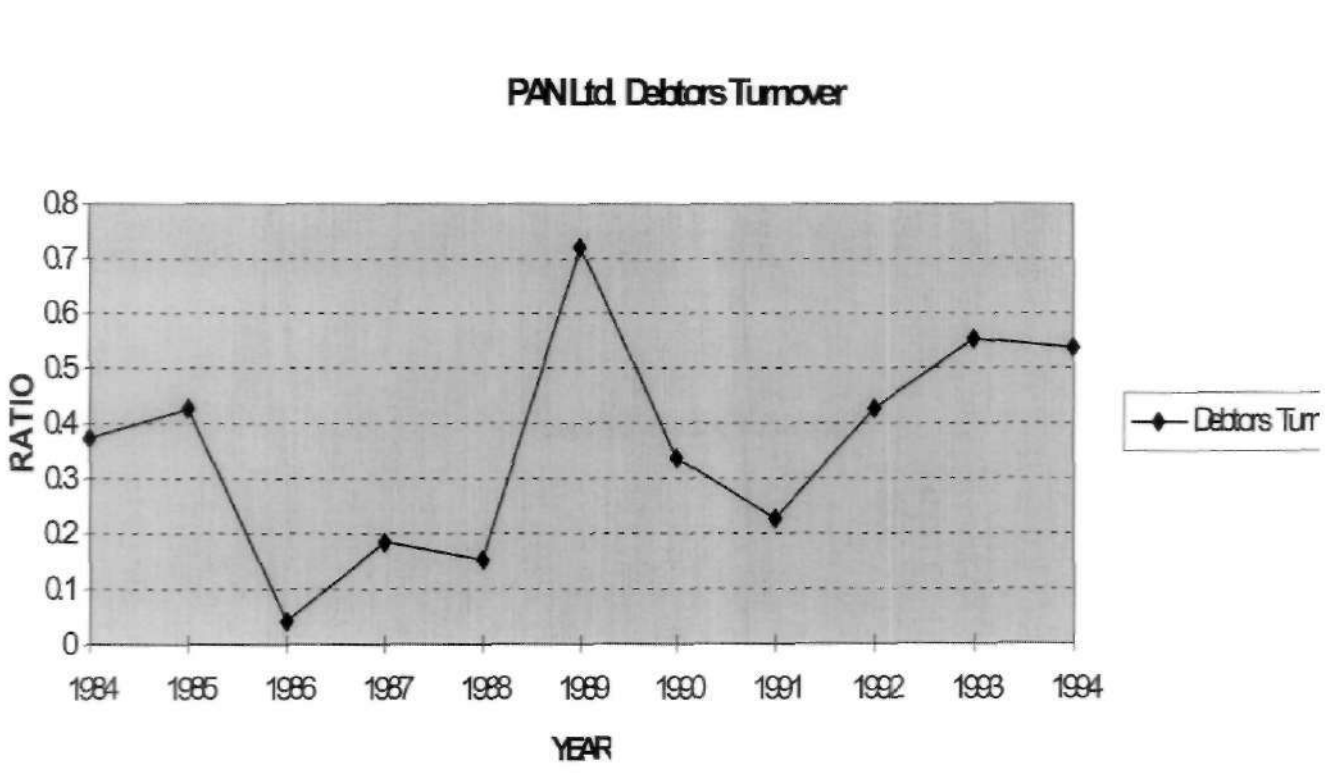


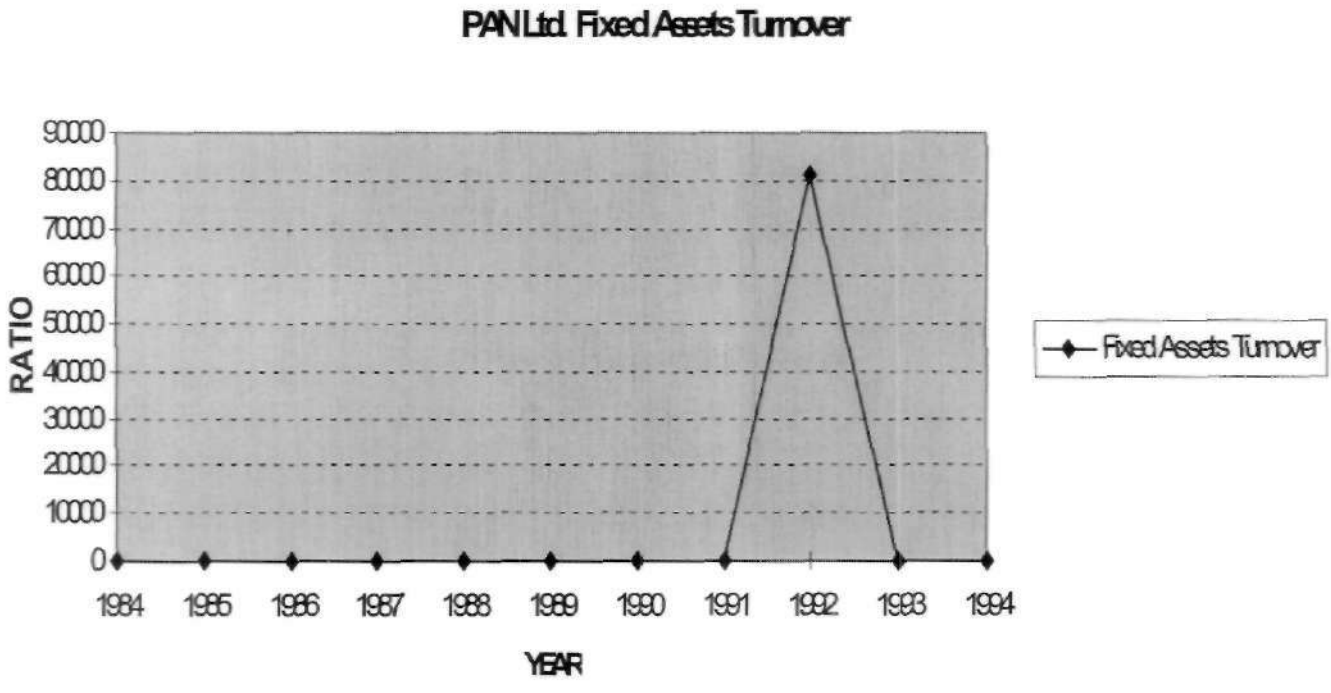

PAN Ltd. Interest Cover Ratio

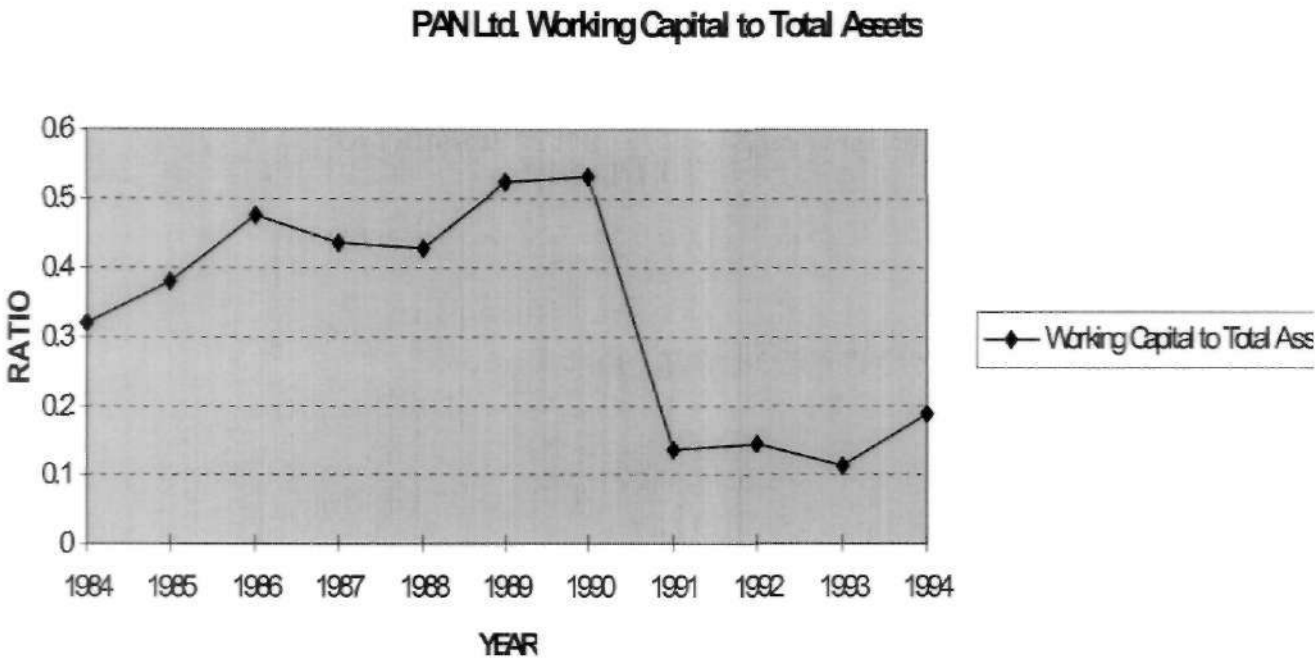


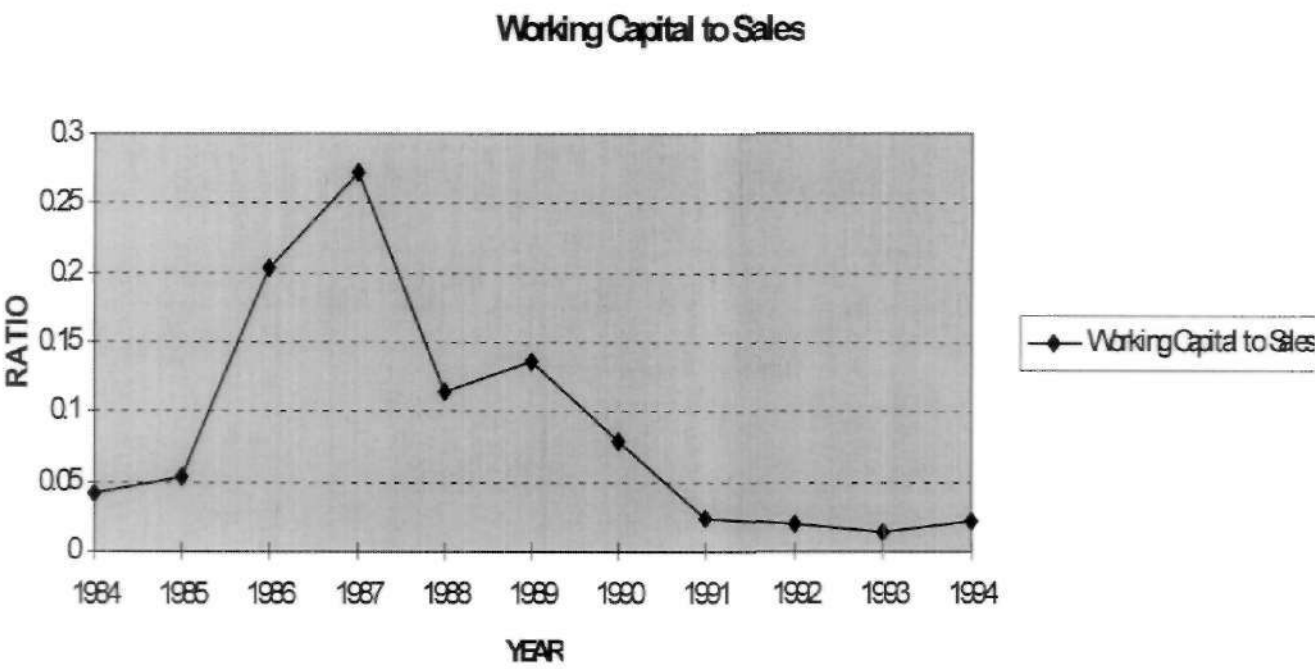

PAN Ltd. Average Collection Period
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Average Collection Perio

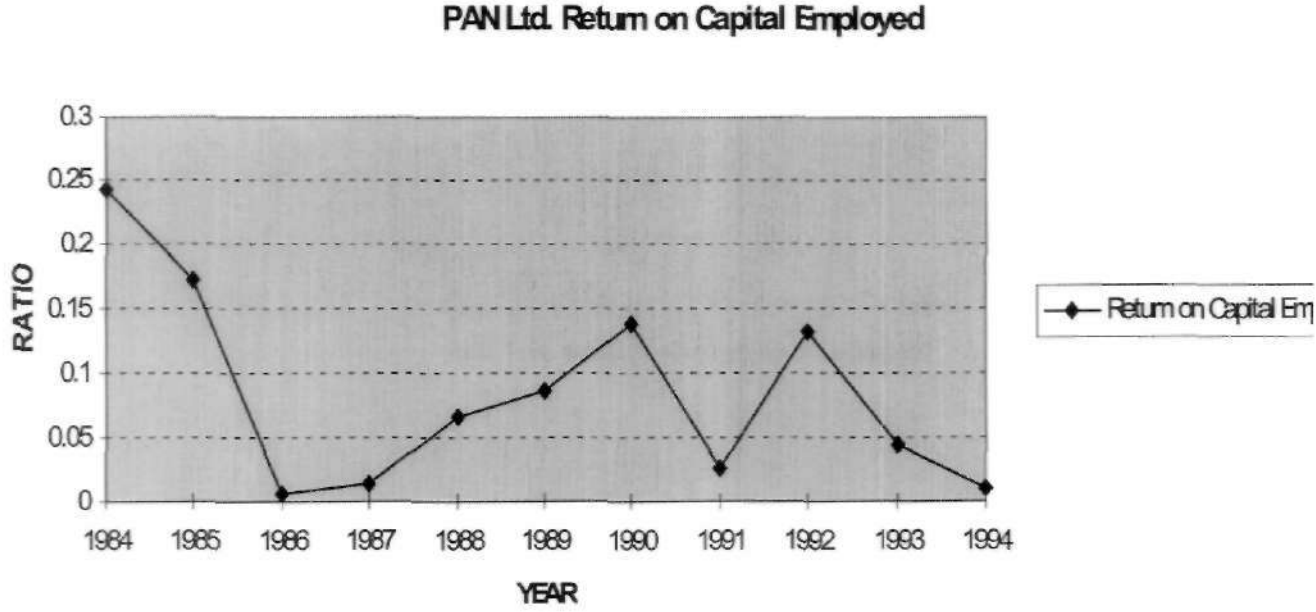

PAN Ltd. Average Payment Period
6000
5000
4000
3000
2000
1000
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Average Payment Pe

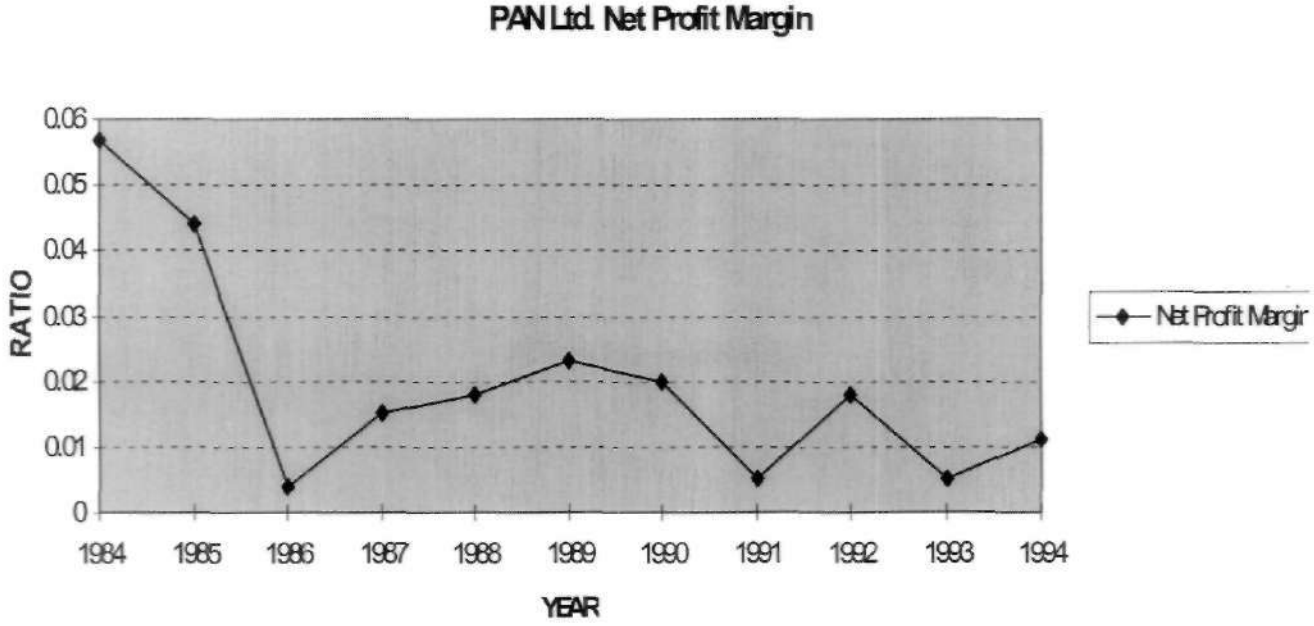

PAN Ltd. Debtors Turnover
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Debtors Turr

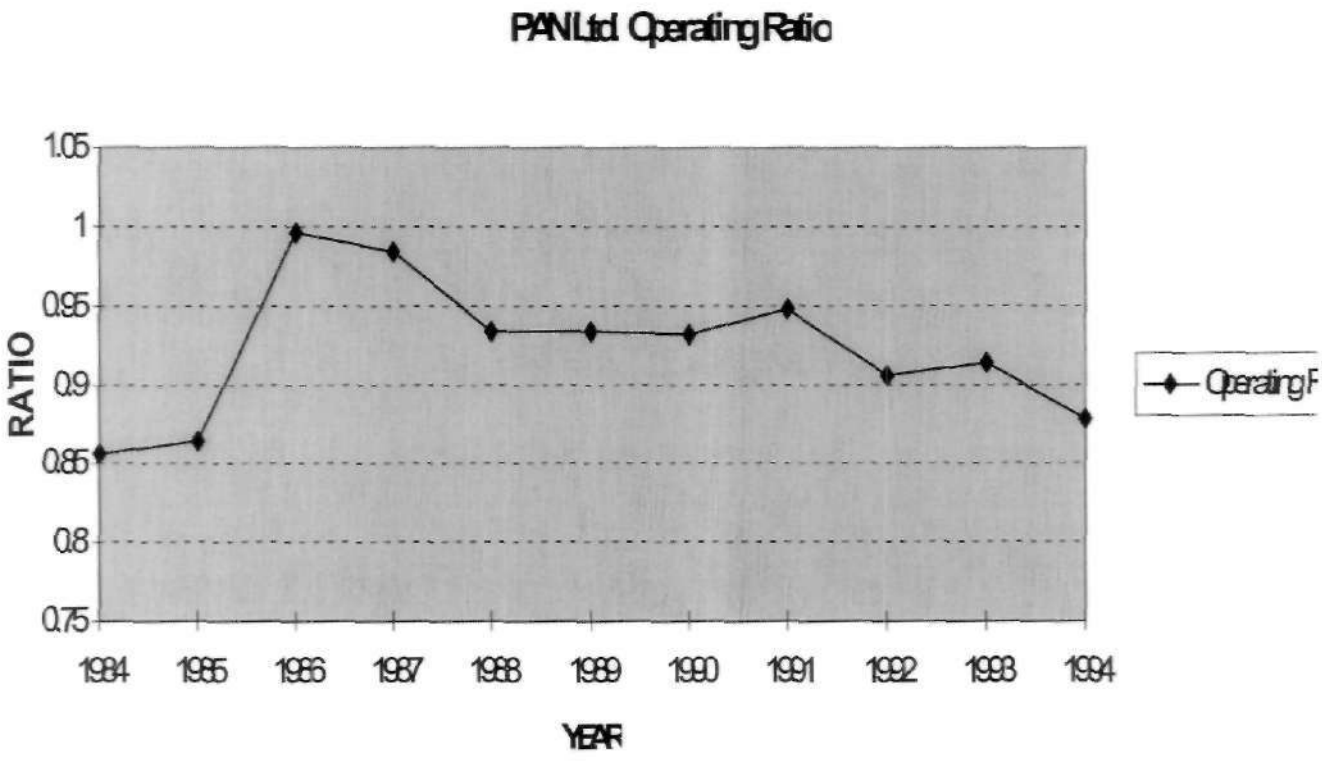

PAN Ltd. Fixed Assets Turnover
90000
80000
70000
60000
50000
40000
30000
20000
10000
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Fixed Assets Turnover


PAN Ltd. Working Capital to Total Assets
RATIO
0.6
0.5
0.4
0.3
0.2
0.1
0
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Working Capital to Total Ass


Working Capital to Sales
RATIO
0.3
0.25
0.2
0.15
0.1
0.05
0
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Working Capital to Sales


PAN Ltd. Return on Capital Employed
0.3
0.25
0.2
0.15
0.1
0.05
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Return on Capital Em


PAN Ltd. Net Profit Margin
0.06
0.05
0.04
0.03
0.02
0.01
0
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Net Profit Margir


PAN Ltd Operating Ratio
1.05
1
0.95
0.9
0.85
0.8
0.75
RATIO
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
YEAR
Operating R

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