THE USE OP FINANCIAL RATIOS IN
THE EVALUATION OP CORPORATE PERFORMANCE:

A CASE STUDY OF TWO SELECTED TEXTILE
COMPANIES IN KADUNA

BY

ICHADO REUBEN OKOLIKO

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CERTIFICATION

This project entitled "THE USE OF FINANCIAL RATIOS IN THE EVALUATION OF CORPORATE PERFORMANCE: A CASE STUDY OF TWO SELECTED TEXTILE COMPANIES IN KADUNA" meets the requirements and regulations governing the award of the Degree of Masters of Business Administration of Ahmadu Bello University, Zaria and is hereby approved for its contribution to knowledge and literary presentation.

Supervisor:
MAL. IBRAHIM F. OKEJI

Date

9-12-98

Head, Dept of Business Administration

Date

External Examiner

Date

11/08/99

Dean, Postgraduate School

Date

DECLARATION

I hereby declare that this academic work is a record of my own personal efforts. It has not been presented in any application for a Higher degree. All sources of information are specifically acknowledged by way of references.

ICHADO REUBEN OKOLIKO

DEDICATION

This work is dedicated to my parents who, despite their poor financial position, ensured that I received adequate education in my life.

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ABSTRACT

This project deals with the analysis of results of Arewa Textiles Plc and United Nigerian Textiles Plc (consolidated) all in Kaduna, over a period of five years (1987-1991). A total number of 14 (fourteen) ratios were used to analyse their performances over the said period.

The current ratio for the two companies falls below the traditional standard of 2:1. On the whole, Arewa Textiles **Plc has** better performance over the five years.

The Acid test ratio for the two companies also falls below the ideal situation of 1:1. However, the result of United Nigerian Textiles Plc (consolidated) is better off over the period under review.

The debt ratios for the two companies fluctuated with United Nigerian Textiles Plc (consolidated) having higher ratios in the first two years.

United Nigerian Textiles Plc (consolidated) also has higher stock turnover ratios over the years than Arewa Textiles Plc. On the other hand, Arewa Textiles Plc has shorter average collection period.

The profitability ratios also indicate that United Nigerian Textiles Plc (consolidated) has higher return on capital employed in **the** first two oyears while Arewa Textiles moved higher in the last three years.

The profit margin on sales also shows that United Nigerian Textiles **Plc** has better result in **the** first four years. However, **the** Return **on** Total Assets for Arewa Textiles are higher in the first three

years and year five. The Return on Equity for United Nigerian Textiles Plc is higher in the first two years while Arewa Textiles has higher returns in the last three years.

The Earnings Per Share ratio shows higher returns for Arewa Textiles over the five years. The dividend per share for Arewa Textiles Plc is also greater in the first three years and year five.

Having identified the difficulties and shortcomings depicted by the above ratios, a number of recommendations are therefore outlined to rectify their poor financial positions.

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CHAPTER ONE

INTRODUCTION

1.1 Background

The study of financial management started in the early part of this century with emphasis at that time on legal matters such as consolidations, formation of new companies and the raising of different types of securities by companies. The emphasis solely centred on how to obtain capital for business expansion. This development however coincided with the rapid industrialisation in Europe and America. In the 1930s many business concerns collapsed as a result of the great depression which consequently led to the shifting of business attention towards liquidation, bankruptcy, corporate reorganisation and corporate liquidity, etc.

In the 1940s and early 1950s financial management continued to be studied as a descriptive subject viewed from the outsider's perspective rather than from the standpoint of management ie. the insiders. In this regard, therefore, attention shifted to Asset analysis and mathematical models were consequently developed and began to be applied to inventory management, cost forecasting, debts analysis, etc. Hence the focus of financial management shifted from the outsiders' perspective to insiders' as financial decisions within the enterprise were recognised to be the critical issue in the corporate finance. As the century moved into the 1960s, the trends continued and a lot of knowledge was gained in the field of finance which has resulted in new developments in almost every decade.

Like every other area of responsibility, Financial Management can be defined in relation to the functions and responsibilities the finance managers perform. These functions vary from one organisation to another but basically are similar. While the specifics vary among organisations, the key finance functions are investment, financing, and dividend decisions of an organisation. Funds are raised from external financial sources and allocated for different uses. These finance functions are performed in all organisations - from business firms to government units or agencies, charities, etc. Benefits to these financing sources take the form of returns, repayments, products and services.

Critical to this study is the function of Financial Analysis of financial data. According to K.W. Melcalf and M.L. Fitard (1976) Financial Analysis of financial data "is a process of evaluating the relationship between the component parts of a financial statement to obtain a better understanding of a financial position and performance of an entity."

So far, this Chapter has explained what financial management is, the fundamental changes regarding its scope and coverage since the early years of its evolution and also its functions and a brief introduction of what financial analysis is. The rest of this Chapter will be devoted to the discussion on the purpose of this study, the significance of financial analysis, the scope of the study and a brief history of the companies selected for the study.

1.2 Purpose of the Study

The purpose of this study is to use financial ratios as tools to analyse, evaluate and predict the profitability, liquidity and viability of the textile industry in Nigeria giving specific attention to Arewa Textiles Plc and United Nigerian Textiles Plc (Consolidated) all in Kaduna.

1.3 Significance of Financial Ratios

Financial management refers to the effective acquisition and utilisation of funds. The success of every organisation largely depends on the volume of funds at its disposal. This therefore makes it imperative for firms to source these funds either through the issue of new shares, debentures or loans. It is however apparent that before these potential suppliers of capital part with their resources, they would like to know the financial position of the firm concerned and possibly its ability to pay dividends or interests and pay back the principal on maturity. To get this information, therefore, requires the analysis of financial activities of the firm concerned. This process is called financial analysis.

In essence, therefore, financial ratios are used to compute, analyse, predict and compare the conditions and performances of business enterprises in order to evaluate their liquidity, profitability and viability. It is against this background that the writer has chosen this topic.

1.4 Scope Of The Study

This study is intended to use financial ratios as tools to evaluate the financial activities, conditions and performances of the two selected companies over a period of five years (1987-1991).

1.5 Brief History Of The Companies

Arewa Textiles Plc was incorporated in 1963 and started production in 1965 with product lines consisting of singlets and pants alongside with fabrics on a small scale. It expanded its scope in 1970s with the installation of new machines with product lines consisting of superb prestige and yarns.

The fully paid share capital in 1991 was 10,000,000 Ordinary Shares of ₦2.00 each (₦20,000,000.00) out of which Nigerians had interest of 40%.

On the other hand, United Nigerian Textiles Plc was incorporated in 1964. It engages in the textile manufacturing business with product lines consisting of real wax and superb prints. The issued and fully paid share capital in 1991 was 122,400,000 Ordinary Shares of 50K each. The ownership structure is as follows;

Foreign	..	59%
Nigerian	..	41%
		100%

United Nigerian Textiles Plc has somo subsidiaries and associated companies. While the subsidiaries are Zamfara Textiles Industries Plc and Funtua Textiles Ltd, the associates are Supertex Ltd and Unitex Ltd.

CHAPTER TWO

LITERATURE REVIEW

2.1 The Concept of Financial Ratios

Financial analysis is the process of identifying the financial strengths and weaknesses of an organisation by properly establishing relationship between the items of the Balance Sheet and the Income Statements.

Ratios refer to the numerical or quantitative comparison between two items or variables. These ratios are expressed in three ways;

- as a percentage
- in fractions
- as relation between one variable and the others

It is important to recognise that the Balance Sheet is a statement that shows the firm's financial position at any given point in time, while the Profit and Loss account shows the results of operations during an interval of time. Thus, the balance sheet represents a snapshot of the firm's position on a given date, while the profit and loss account is based on a flow concept, showing what occured between two points in time.

2.2 Standards of Comparison

Ratios are not ends to themselves but a means to an end. It therefore requires the comparison of variables to obtain useful interpretation of financial statements. Since single ratio does not show any reasonable judgement until it is relatively compared to another, it is absolutely necessary to make use of some standards.

Some of these standards are;

- Ratios calculated from the past financial statements of the same company
- Ratios developed using the projected financial statements of the same company
- Ratios of some selected firms in the same industry at the same point in time - industry average
- Ratios of different industries, but this has its reservations.

2.3 Types of Comparison

The key to obtaining meaningful information from ratio analysis is comparison. This means that ratios are compared over time within the same business to determine whether things are improving or deteriorating. Secondly, ratios are compared between similar firms to establish whether one firm is better off or worse than average within a specific industry. The foregoing could conviniently be classified as time-series and cross-sectional approaches respectively.

2.4 Basic Types of Ratios

Each type of analysis has a purpose or use that determines the relationships emphasised in the analysis. The analyst may, for example, be a banker considering whether or not to grant a short term loan to a firm. He will primarily be interested in the firm's short-term or liquidity position, so he will stress ratios that measure liquidity. On the other hand, long-term creditors place more emphasis on earnings capacity and also on operating efficiency. It is very well known to them that unprofitable activities will definitely erode asset values and that a strong current position does not necessarily guarantee that funds will be available to repay say, a thirty-year debenture issue. It is in this wise interesting to note that equity investors are in the same vein concerned with long-term profitability and efficiency. The management, of course, is interested in all the aspects of financial analysis.

From the foregoing, it is useful to classify ratios into six fundamental categories which are;

-Liquidity Ratios ..	These ratios measure the firm's ability to pay off its maturing short term obligations.
-Gearing Ratios ..	These ratios measure the extent to which the firm has been financed by debt.
-Activity Ratios ..	These ratios measure effectively how a firm uses its resources.
-Profitability Ratios ..	These ratios measure the effectiveness of the firm's management as depicted by the returns generated on sales and investment.
-Growth Ratios ..	These ratios measure the ability of the firm to maintain its economic position in the growth of the economy and industry.
-Valuation Ratios ..	These ratios depict the ability of management to create market values in excess of investment, ie. cost outlays.

2.4.1 The Liquidity Ratios

These ratios measure the company's ability to meet its short term maturing obligations. Is the company able to meet its current liabilities? Basically, two ratios fall under this classification. They are;

(a) Current Ratio

(b) The Acid Test Ratio

(a) The Current Ratio

The current ratio is the most commonly used ratio to measure the short term solvency of a firm. Its advantage is that it indicates the extent to which the claims of short term creditors are covered by assets that are expected to be converted to cash in a period roughly corresponding to the maturity of the claims. Current assets normally include cash, quoted investments, trade debtors and stocks; current liabilities consist of trade creditors, short term loans, maturing long term liabilities, corporation tax due and other accrued expenses (principally wages).

The current ratio is calculated by dividing the current assets by the current liabilities.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

It is measured in a relative term ie. a high value of current ratio is considered as an indication that the firm is liquid enough and therefore can pay off its maturing short term bills. On the other hand, a relatively low value of the ratio suggests that the company will find it difficult to pay off its bills. However, the general rule is that a current ratio of 2:1 or more is acceptable.

(b) **The Acid Test Ratio**

This ratio is also known in some quarters as Quick Ratio because of the ease with which it can be converted into cash. This ratio is calculated by removing the stock element from the current assets and dividing the remainder by the current liabilities. It is widely believed that stocks are the least liquid of a company's current assets and the assets on which losses are most likely to occur in the event of disposal. An asset is liquid when or if it can be converted to cash immediately or very soon without any loss in its value. Hence it is considered to be a more refined measure of a firm's liquidity. It is calculated as;

$$\text{Acid Test Ratio} = \frac{\text{Current Assets - Stocks}}{\text{Current Liabilities}}$$

An acid test ratio of 1:1 or more is preferable but it should be borne in mind that an acceptable value generally depends on the industry average.

2.4.2 Gearing Ratios

The debt position of the firm shows the amount of other people's funds that are being used to generate profits. In essence, therefore, gearing ratios typically measure the funds supplied by owners of a firm as compared with the funds provided by the creditors. The way a firm is financed has some implications which obviously include, firstly, creditors look to the equity, or owner-supplied funds, to provide a margin of safety. If owners have provided a small proportion of total financing, the risks of the company would be borne mainly by the creditors. Secondly, by raising funds through debt, the owners gain the benefit of maintaining control of the firm with a limited investment. Thirdly, if the company earns more on the borrowed funds than it pays in interest, the return to the owners will be magnified. This process of magnifying shareholders' return is usually referred to as 'Trading on Equity'.

It is widely accepted that firms that have low gearing ratios are less risky in terms of loss when the economy is in a recession and also have lower expected returns when the economy is experiencing a boom period. On the other hand, firms with higher gearing ratios run the risk of larger losses but also have a chance of gaining high profits. The prospects of high returns are therefore desirable but investors are in most cases risk averse. Hence decisions about the use of gearing must balance higher expected returns against increased risk.

The ratios to be considered under this classification include the Debt ratio, Debt Equity ratio, Fixed Charge Coverage ratio and Times Interest earned ratio.

(a) **Debt Ratio**

This ratio is also called the total debt to total assets ratio and measures the percentage of total funds provided by creditors. Debt in this case includes current liabilities and all loans. It is natural that creditors prefer moderate debt ratios, since it is believed that the lower the ratio, the greater the cushion against creditors' losses in the event of liquidation. On the other hand, the owners of the firm may prefer high gearing either to magnify their returns or to avoid equity dilution since raising new equity means giving up some degree of control. In the same vein, if debt ratio is too high, there is the danger of encouraging irresponsibility on the part of the owners. The higher the debt ratio the more financially levered a firm becomes. The debt ratio is therefore computed as;

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

(b) **The Debt Equity Ratio**

This ratio unlike the preceding ones measures the relationship between the funds provided by the owners of the business entity and those provided by the creditors. It is a measurement of the financial leverage of the firm.

It is computed as;

$$\text{Debt Equity Ratio} = \frac{\text{Long Term Debt}}{\text{Stockholders' Equity}}$$

The stockholders' equity is simply the networth of the firm. It is a known fact that firms with large amount of fixed assets and stable cashflows have every tendency to maintain high debt equity ratio. Other less capital intensive firms normally have lower debt equity ratios. Nevertheless, an industry average is a good parameter with which to compare a debt equity ratio.

(c) The Times Interest Earned Ratio

The times-Interest-Earned also known as the interest cover ratio is computed by dividing earnings before interest, and taxes (Gross Income) by the interest charges. This ratio measures the extent to which earnings can dwindle without causing any resultant financial embarrassment to the firm because of inability to meet annual interest costs. In the event of inability to meet this obligation, legal action may be instituted by the creditors and the consequence might be liquidation or bankruptcy. It is computed as;

$$\text{Times Interest Earned} = \frac{\text{Gross Income}}{\text{Interest Charges}}$$

$$= \frac{\text{Profit before tax + Interest Charges}}{\text{Interest Charges}}$$

(d) The Fixed Charge Coverage Ratio

This is similar to the times interest earned ratio, but it is somehow more inclusive in that it recognises that many firms lease assets and incur long-term obligations under lease contracts. Leasing has become quite widespread in recent times, making this ratio more preferable to the times interest Earned ratio for most financial analyses. For the purposes of this analysis, fixed charges are defined as Interest plus annual long term lease obligations, and the fixed charge coverage ratio is defined as;

Fixed Charge Coverage =

$$\frac{\text{Proit before taxes + Interest Charges + Lease Obligation}}{\text{Interest Charges + Lease Obligations}}$$

2.4.3 The Activity Ratios

These ratios measure how effectively a company utilises the resources at its disposal. The ratios involve comparison between the level of sales and the investment in various asset accounts eg. stocks, debtors, fixed assets and so on. These ratios are briefly stated as follows;

(a) **Stock Turnover Ratio**

This ratio is simply defined as sales divided by stocks. It is a measure of how well the stocks of the firm are being used to generate sales. Stock turnover is expressed as 'X times' so that stocks generate X times their value in annual turnover. It is computed as follows;

$$\text{Stock turnover} = \frac{\text{Sales}}{\text{Stocks}}$$

An industry average is generally a good comparative figure.

(b) **Average Collection Period**

The average collection period, which is a measure of the debtors' turnover is computed in two ways;

(i) annual sales are divided by 360 days to get the average daily sales

(ii) daily sales are divided into trade debtors to find the number of days' sales tied up in debtors. This is defined as the average collection period, because it represents the average length of time that the enterprise must wait after making a sale before receiving cash. The ratio is calculated as follows;

$$\text{Sales per day} = \frac{\text{Sales}}{360}$$

$$\text{Average Collection Period} = \frac{\text{Debtors (Trade)}}{\text{Sales Per Day}}$$

This ratio generally can be evaluated by comparison with the terms on which the firm sells its goods.

(c) **The Fixed Assets Turnover Ratio**

This ratio measures the turnover of plant and equipment. This ratio measures how well fixed assets are used to generate sales. It is calculated as;

$$\text{Fixed Asset Turnover} = \frac{\text{Sales}}{\text{Net Fixed Assets}}$$

(d) **Total Assets Turnover Ratio**

This ratio measures the turnover of all the firm's assets. It is a measure of how well all the assets are utilised to generate sales. It is computed as;

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

2.4.4 Profitability Ratios

There are a large number of measures of profitability each relating the returns of the firm to either the sales, its assets or equity. Profitability is the net result of a large number of policies and decisions. These ratios give final answers about how effectively a firm is being managed. For a firm to remain in business it has to be profitable, and obvious checks on profitability are;

(a) Whether the company has made a profit or loss on its ordinary activities.

(b) By how much this year's profit or loss is bigger or smaller than the previous year's profit or loss.

Some of the profitability ratios that will be considered here include;

(a) The Return on Capital Employed (ROCE)

(b) The Profit Margin on Sales

(c) Return on Total Assets

(d) Return on Networth

(a) **The Return on Capital Employed**

The most important profitability ratio is therefore return on capital employed which measures the profit as a percentage of the amount of capital employed. Profit is usually taken as Profit Before Interest and Taxation (PBIT) and capital employed is shareholders' capital plus long term liabilities and debt capital.

$$\text{Return on Capital Employed} = \frac{\text{Profit Before Interest and Tax}}{\text{Capital Employed}}$$

(b) The Profit Margin on Sales

The profit margin on sales is computed by dividing net income after taxes by sales. This therefore gives the profit per ₦1.00 of sales. This measures the percentage of Naira sales remaining after all expenses including taxes have been deducted. It is calculated as;

$$\text{Profit Margin} = \frac{\text{Net Profit After Tax}}{\text{Sales}}$$

(c) Return on Total Assets

The return on total assets seeks to measure the effectiveness with which the firm has employed its total assets. It is also called Return on Investment (ROI). It is calculated as;

$$\text{Return on Total Assets} = \frac{\text{Net Income + Interest (I-T)}}{\text{Total Assets}}$$

(d) Return on Networth (Equity)

The ratio of net profit after taxes to networth seeks to measure the rate of return on the shareholders' investment. It is simply calculated as;

$$\text{Return on Networth} = \frac{\text{Net Income After Tax}}{\text{Networth}}$$

2.4.5 Growth Ratios

Growth ratios measure how well the firm maintains its economic position in the economy as a whole as well as in its own industry. During the recent period of inflation, the interpretation of growth ratios has become more difficult.

Some of the ratios that fall under this category are;

(a) Sales growth

(b) Net income growth, and

(c) Dividends per share

2.4.6 Valuation or Shareholders' Investment Ratios

This is a set of ratios that helps equity shareholders and other investors to assess the value and quality of an investment in the ordinary shares of a firm. These ratios are the most comprehensive measures of performance for the firm in the sense that they reflect the combined influence of risk ratios and return ratios. These include;

(a) Earnings per share

(b) Dividend per share

(c) Dividend Cover

(d) Price earning ratio

(e) Dividend yield, and

(f) Earnings yield

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

(a) **Earnings Per Share**

Earnings per share (EPS) is widely used by investors as a measure of a company's performance and is particularly important in;

- Comparing the results of a company over a period of time;
- Comparing the performance of one company's equity, and also against the returns obtainable from loan stock and other forms of investment.

The purpose of this ratio is to achieve as far as possible clarity of meaning, comparability between one company and another, one year and another, and attributability of profits to the equity shares. It is calculated as follows;

$$EPS = \frac{\text{Earnings}}{\text{No. of equity shares in issue}}$$

(b) **Dividend Per Share**

This ratio is self explanatory and is clearly an item of interest to shareholders.

It is calculated as;

$$DPS = \frac{\text{Total Dividend}}{\text{Total No. of equity shares in issue}}$$

(c) **Dividend Cover**

This ratio shows what proportion of profit on ordinary activities for the year that is available for distribution to shareholders has been paid or proposed and what proportion will be retained in the business for future expansion. Usually, a dividend cover of 2 times would indicate that, ignoring extra-ordinary items, the company had paid 50% of its distributable profits as dividends and retained 50% in the business to help to finance further expansions.

It is calculated as;

$$\text{Dividend Cover} = \frac{\text{Earnings Per Share}}{\text{Net Dividend Per Ord. Shares}}$$

(d) **Price/Earning Ratio**

The price/earning ratio is the ratio of a firm's current share price to the earnings per share. A high P/E ratio will indicate strong shareholder confidence in the company and its future. For example in profit growth and lower P/E ratio indicates lower confidence. It is however worthy of note to state that the P/E ratio of one firm can be compared with the P/E ratios of;

- Other firms in the same industry
- Other companies outside the industry.

(e) **Dividend Yield**

This is defined as the return a shareholder is currently expecting on the shares of a firm. It is calculated as;

$$\frac{\text{Dividend on the share for the year (grossed up) x 100\%}}{\text{Current Market value of the share (ex div)}}$$

The Dividend per share is taken as the dividend for the previous year and inclusive of the withholding tax. The net dividend is the actual cash paid and the gross dividend is found by multiplying the net dividend by a factor of;

$$\frac{100}{(100-1T)}$$

where,

IT is here the rate of withholding tax. Thus given a rate of tax deduction of 20%, the gross dividend is the net dividend multiplied by a factor of 100/80. Dividend yield is therefore an important aspect of share's performance.

(f) **Earnings Yield**

This ratio is measured as the earnings per share, grossed up, as a percentage of the current share price. It indicates what the dividend yield could be, given;

- The company paid out on its profit as dividends and retained nothing in the business
- there were no extra ordinary items in the Profit and Loss account.

It attempts in most cases to improve the comparison between investments in different companies by overcoming the problem that firms have differing dividend covers. It is however not given much publicity as EPS, P/E ratio, dividend cover and dividend yield.

2.5.0 The Predictive Power of Financial Ratios

It is pertinent to state that since the beginning of the development of financial ratios several researchers had on different studies found some predictive power of financial ratios. Some of these are as follows;

(i) Financial ratios and corporate failure
(ii) Financial ratios and corporate risk
(iii) Financial ratios and bond rating
(iv) Financial ratios and rapid growth and profitable firms

2.5.1 Financial Ratios and Corporate Failure

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

The works of some eminent scholars such as Fitzpatrick (1931 and 193 Smith and Winakor (1935), Charles L. Merwin (1942) are taken into consideration in analysing the first category. Smith and Winakor studied a sample of 183 firms which had experienced some financial difficulties during the period of 1923 to 1931 and had finally failed by 1931. They analysed the prior ten year trends of the means of 21 ratios and concluded that the ratio of net working capital to total assets whose decline began ten years before the occurence of financial difficulties was the most accurate and steady indicator of business failure. Their data actually indicated that the long-term solvency ratios were equally good indicators. Fitzpatrick however used a different approach by analysing the prior three to five year trends of thirteen ratios of twenty firms that have failed during the period 1920 to 1929. He studied the data on a case-by-case method of analysis and followed it up by comparative analysis of a matched sample of nineteen successful firms. He however concluded that all his ratios predicted failure to some extent through declining trends but also stated that his best predictors were the net profit to net worth ratio and the net worth to total debt ratio.

The above two studies were incorporated in Merwin's 1942's study of a sample of 939 firms in the period 1926 to 1936. He divided his sample into two groups as "continuing" (successful) and "discontinuing" (unsuccessful) firms and analysed the prior six year trend of a large unspecified number of ratios of each group. He accomplished this by comparing industry mean ratios of the discontinuing firms with 'estimated normal' ratios, which were estimates of what the discontinuing firms' ratios would have been had they maintained the same average ratios as the continuing firms. His conclusion was that three ratios were very sensitive predictors of discontinuance upto as early as four to five years in some instances. These ratios were net working capital to total assets, networth to total debt and the current ratio. These ratios all showed declining trends before discontinuance and were also below the estimated normal ratios.

On the other hand, the second category solely relied on the statistical techniques of discriminant analysis. Researchers that contributed to the development of the area of this study included among others; Beaver (1966) and (1968), Altman (1968), Daniel (1968), Deakin (1972), Edminister (1972), Wilcox (1973), and Altman and others (1977).

Beaver (1966) considered a sample of seventy-nine large firms that failed and compared with corresponding non-failed companies of the same size and industry. The data collected were for the same years. These samples were used to test the predictive ability of thirty financial ratios. The mean values of the ratios for the two samples were compared over the five year period prior to failure. He discovered that the mean ratio for the failed companies differed significantly from the successful ones. It also deteriorated significantly as failure was approaching.

Beaver also tested the samples using discriminant analysis and went on to analyse the evidence using likelihood ratios. Though not all the financial ratios examined predicted failure equally, many showed excellent predictive power.

In one of his studies, Beaver (1968) investigated the ability to predict failure from changes in market prices of stocks using four ratios. These included Cash Flow to total liabilities, net income to total assets, total debt to total assets with the market behaviours of prices on a sample of seventy-nine failed and seventy-nine successful firms of approximately same size and industry. He found out that the median market price of the failed companies declined at an increasing rate as failure approached relative to that for non-failed firms. The largest price decline occured in the final year. He concluded that investors adjust stock prices to the deteriorating condition of failing companies. He equally found the evidence to be consistent with investors assessing the likelihood for failure on the basis of financial ratios.

Altman (1968) used discriminant analysis to establish a model for predicting corporate bankruptcy in the United States. He developed a discriminant function with a score, such that he classified all firms with less than 1.81 as bankrupt and all firms with scores more than 2.99 were said to be nonbankrupt while those scores within the range were considered as grey area, where clear classification was not possible. The discriminant function Z was found to be :

$$Z = 0.012X1 + 0.014X2 + 0.033X3 + 0.006X4 + 0.999X5$$

where;

X1 = Working capital/Total assets (in %)

X2 = Retained earnings/Total ssets (in %)

X3 = EBIT/Total assets (in %)

X4 = Market Value of Equity/Book Value of Debt (in %)

X5 = Sales/Total Assets (times)

Z = Overall score

Daniel (1968) in his study employed simple correlation, factor analysis and stop wise regression to select financial statement data and ratios which best correlated with failure and non-failure as the dependent variable. The discriminant function was found to have considerable power in identifying failing firms.

Deakin (1972) using fourteen ratios studied a pair of thirty two failed and non-failed firms for the period between 1964-1970 in a discriminant function as he discovered that he could predict bankruptcy three years before the failure.

Edminister (1972) tested the predictive ability of financial ratios on small businesses starting with fifteen ratios. He concluded that quick assets to current liabilities, working capital to sales, net income plus depreciation - depletion and amortization to current liabilities net worth to sales, current liabilities to net worth, inventory to sales incorporated in discriminant function predicted failure for upto three years on commulative data basis.

2.5.2 Financial Ratios and Corporate Risk

Most of the studies made in the area of prediction of corporate risk by means of financial ratios were carried out in the 1970s. Some of such studies included;

In 1970 Weston used a multiple regression model containing four variables, the logarithism of earning variability, period of solvency, market value of all bonds outstanding and market value of stock to debt ratio to predict upto sixty two per cent of the actual rating by Moody's.

2.5.4 Financial Ratios and Rapid Growth and Profitable Firms

There are several studies in this area but the prominent ones are as follows; In Horrigan (1965), Chudson determined that some short term liquidity and long term solvency ratios in 1937 were significantly different between profitable and unprofitable firms, with the profitable ones having higher ratios but capital turnover ratios were not significantly different.

Jackendoff (1962) also found that financial ratios consistently and clearly distinguished between profitable and unprofitable firms in the period of 1949 to 1955. The current ratio and the working capital to total assets and networth to total debt ratios of profitable firms were consistently higher but the ralationship of total asset turnover appeared to be inverse to size of the firm.

Osaze (1981) in a study on financing rapid growth firms in Nigeria discovered that ratios adequately discriminated between growing and non-growing firms.

2.6.0 **Limitations of Financial Ratios**

The analysis of financial ratios is largely concerned with the efficiency and effectiveness of resource utilization by a company's management and also with the financial stability of the company.
In spite of the numerous benefits derived from financial ratios, there are still some limitations.

Upto date standard industry averages have not been developed in Nigeria. As a result, therefore, comparison between a company's ratios and of the industry has therefore not been possible.

Another limitation is that financial data are drawn from accounting data and these data (accounting) are subject to some manipulations and capable of being interpreted differently. In this regard, therefore, financial ratios generated therefrom may not be considered as an all in all tool for performance evaluation.

The situations of companies are different. This means that the factors influencing the performance of a firm in a year might change in another year. Consequently, the comparison of two companies becomes meaningless when especially they operate under different situations.

Since firms work harder to achieve even better results than the industry average, it can therefore be said that there is nothing sacred about the industry average.

It is very difficult also to compare firms ratios if such firms use different accounting periods and policies.

Sometimes financial statements do not contain enough information for accurate ratio analysis. The management of some companies might also be unwilling to release their true financial statements.

Lastly, the time allowed for the completion of this project is inadequate for indepth and more critical analysis.

CHAPTER THREE

3.1.0 METHODOLOGY

3.1.1 Sample Slection

Two textile companies are randomly selected for this study over a period of five years (1987-1991) taking into consideration time, cost and data availability. These companies are United Nigerian Textiles Plc and Arewa Textiles Plc.

3.1.2 Data Collection

All the data collected, analysed and used for this study were obtained from the Annual Reports of the two companies selected. They were obtained from the Nigerian Stock Exchange, Kaduna, Kaduna State.

3.1.3 Ratio Selection and Comparison

A total number of 14 ratios were used for this study classified into five major groups :

(a) Liquidity Ratios

- (i) Current ratio
- (ii) Acid test ratio

(b) Debt Management Ratio

- (i) Debt ratio
- (ii) Debt-equity ratio

(c) Activity Ratios

- (i) Stock turnover ratio
- (ii) Average collection period
- (iii) Fixed Assets turnover
- (iv) Total Assets Turnover

(d) Profitability Ratios

(i) Return on Capital employed

(ii) Profit margin on sales

(iii) Return on total assets

(iv) Return on Equity (networth)

(e) Shareholders' Investment Ratios

(i) Earnings Per Share

(ii) Dividend Per Share

It is however pertinent to restate that the types of ratio comparison applied in this study are the time series and the cross-sectional approaches.

CHAPTER FOUR

4.0.0 PRESENTATION AND ANALYSIS OF DATA

The results of the various ratios computed from the five years (1987-1991) financial statements of Arewa Textiles Plc and United Nigerian Textiles (and its subsidiaries) are presented in fourteen tables below.

4.1.0 Liquidity Ratios

4.1.1 Current Ratio for the Selected Firms (1987-1991)

Current Ratio (Times)

Table 4.1

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	1.42	1.79	1.52	1.52	1.68
United Nigeria Textiles Plc (Consolidated)	1.21	1.32	1.28	1.36	1.12

SOURCE: Computed by the Researcher

The conventional rule is that a ratio of 2:1 is preferable. This goes to say that a firm with relatively high current ratio is liquid and has the ability to pay its bills as they mature. On the other hand, a low level of current ratio is an indication of illiquidity meaning that the firm will find it difficult to meet its maturing bills. From the above current ratio table the two companies have their ratios below the ideal standard of 2:1. Though below the standard, Arewa Textiles' ratios showed an increasing trend for the first two years and remained constant in 1989 and 1990 but also increased in 1991. United Nigerian Textiles with its subsidiaries also recorded an increase in the first two years, and then fluctuated in the last three years. On the whole, Arewa Textiles Plc had higher ratios than United Nigerian Textiles Plc over the five years. This means that Arewa Textiles can easily meet its maturing obligations than United Nigerian Textiles Plc. This judgement could be wrong at times especially if a firm has been over king. The effect of overstocking is an indication of inventory under-utilisation and incurring unnecessary storage costs which could all reduce a firm's profitability. By growth trend, Arewa Textiles Plc shows a better future.

4.1.2 Quick Ratio (Times)

Table 4.2

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	0.49	0.61	0.54	0.47	0.41
United Nigerian Textiles Plc (Consolidated)	0.65	0.78	0.73	0.68	0.56

SOURCE: Computed by the Researcher

The recommended ratio for quick ratio is 1:1. It can be seen from the above table that the two companies' ratios have fallen short of the standard ie. 1:1. Arewa Textiles Plc's quick ratios over the five years showed an increase in the second year but were declining gradually in the last three years, an indication of declining liquidity.

United Nigerian Textiles Plc with its subsidiaries had higher ratios comparatively over the years. Nevertheless, it had decreasing ratios as from 1989. This is also a sign of decreasing liquidity. This ratio gives better information about a firm's liquidity than the current ratio because it does not include the inventory element. Hence, the issue of overstocking or inventory under-utilisation does not arise. It should be noted however that quick ratio may increase due to over-holding of cash by a firm. On the whole, United Nigerian Textiles Plc, with its subsidiaries, can easily meet its short term maturing obligations than Arewa Textiles Plc.

4.2.0 **Debt Management Ratios**

4.2.1 Debt Ratio (%)

Table 4.3

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	74	64	72	72	67
United Nigerian Textiles Plc (Consolidated)	84	84	57	60	67

SOURCE: Computed by the Researcher

From the above, it can be seen that the ratios for both companies fluctuate but generally they are high. This shows that there is more debt in the companies' financial structure. This therefore may discourage some potential creditors. On the whole, Arewa Textiles Plc had lower ratios than United Nigerian Textiles Plc in the first two years. In 1989 United Nigerian Textiles Plc (Consolidated) had lower ratio than Arewa Textiles. In 1990, United Nigerian Textiles had a ratio of 60% and in 1991 both companies had the same ratio of 67%. Owners of the business may seek high gearing ratio to magnify their earnings because selling new stock will mean dilusion of equity. If debt ratio is too high and the venture is successful, it will yield a substantial percentage raturn to the owners. If the venture is unsuccessful, only a moderate loss is incurred by the owners because their investment is relatively small.

4.2.2 Debt-Equity Ratio (%)

Table 4.4

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	0	0	0	0	30
United Nigerian Textiles Plc (Consolidated)	106	128	37	44	34

SOURCE: Computed by the Researcher

It should be noted that uptil 1990 Arewa Textiles Plc did have long term debt in its financial structure. Hence there was 0% ratio from 1987-1990 and 30% in 1991. Firms with large amount of fixed assets and stable cash flows normally have high debt-equity ratio while less capital intensive firms have lower debt-equity ratio normall From the above table it can be said that United Nigerian Textiles Plc with its subsidiaries had the highest ratio in 1988 of 128% and started fluctuating as from 1989 to 1991. The higher the ratio the more difficult it becomes for a firm financially. This therefore shows that United Nigerian Textiles Plc with its subsidiaries had more financial problem than Arewa Textiles Plc over the period under review.

4.3.0 **Activity Ratios**

4.3.1 Stock Turnover Ratio (Times)

Table 4.5

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	1.79	2.81	2.57	1.99	1.95
United Nigerian Textiles Plc (with its subsidaries)	2.41	3.29	4.07	3.27	3.79

SOURCE: Computed by the Researcher

This ratio measures the number of times stock is being turned over into receivables through sales. The table above shows that United Nigerian Textiles Plc with its subsidiaries had higher ratios in all the years. In each year United Nigerian Textiles Plc turned over its stock many more times than Arewa Textiles. Arewa Textiles Plc had its highest ratio in 1988 and began to decline thereafter. The ratios for United Nigerian Textiles showed an increasing trend until 1990 when it came down to 3.27 times and rose again in 1991 to 3.79 times. What we should note about this ratio is that when it is high it is suggestive probably of future shortages and may result to a firm's maintaining low level of raw materials and finished goods. Low level of raw materials could cause future short downs of the firm's production and low level of finished goods may indicate that a firm could suffer from future loss of sales due to its inability to deliver its products promptly. On the other hand, a low inventory turnover may indicate low management of inventory leading to the firm incurring high costs from over-stocking raw materials and finished goods.

4.3.2 Average Collection Period (Days)

Table 4.6

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	13	6	.06	4	3
United Nigerian Textiles Plc (Consolidated)	77	103	77	68	9

SOURCE: Computed by the Researcher

The average collection period represents the average length of time a firm must wait after making a sale before receiving cash. The average collection period for Arewa Textiles decreased over the years while the one for United Nigerian Textiles Plc with its subsidiaries fluctuated but were comparatively higher than those for Arewa Textiles Plc. The above table shows that Arewa Textiles Plc received its cash after sales earlier than United Nigerian Textiles Plc.

4.3.3 Fixed Asset Turnover (Times)

Table 4.7

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	9.18	11.73	15.71	22.66	27.31
United Nigerian Textiles Plc (Consolidated)	5.35	7.17	1.89	2.29	3.27

SOURCE: Computed by the Researcher

This ratio measures the utilisation of fixed assets. High ratio is usually an indication of efficient utilisation of fixed assets while low ratio indicates under-utilisation of fixed assets.

The above table shows that Arewa Textiles Plc had a growth trend over the years whereas that of United Nigerian Textiles Plc with its subsidiaries had increased ratio within the first two years and declined in 1989. It started increasing minimally during the last two years. Comparatively, therefore, Arewa Textiles Plc had a higher fixed asset turnover than United Nigerian Textiles Plc with its subsidiaries. One thing that should be noted however is that variation in ratio could be as a result of sizes of Fixed Assets. This goes to show that if a company has a small size of fixed assets and it utilises them efficiently the ratio will be high. On the other hand, if a firm has a large size of fixed assets but with low utilisation, its ratio will be low.

4.3.4 Total Asset Turnover (Times)

Table 4.8

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	1.04	1.61	1.50	1.30	1.40
United Nigerian Textiles Plc (Consolidated)	0.92	1.13	0.90	0.94	1.18

SOURCE: Computed by the Researcher

Total asset turnover ratio shows how a firm efficiently manages its total assets to generate maximum sales through their proper utilisation. The higher the ratio the better result for the firm.

The ratio for the two companies over the years fluctuated but on the whole the table shows that Arewa Textiles Plc showed higher ratios over the years than United Nigerian Textiles Plc. The ratio for United Nigerian Textiles Plc with its subsidiaries increased in 1988 and decreased in 1989 but started increasing again in 1990. It is therefore easier to predict a growth trend with United Nigerian Textiles Plc than Arewa Textiles Plc.

4.4.0 **Profitability Ratios**

4.4.1 Return on Capital Employed (%)

Table 4.9

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	46	37	54	46	48
United Nigerian Textiles Plc (Consolidated)	64	65	19	35	39

SOURCE: Computed by the Researcher

Return on Capital Employed measures the profit as a percentage of the amount of capital employed. United Nigerian Textiles Plc with its subsidiaries shows higher returns in 1987 and 1988 but declined to 19% in 1989. The trend also started growing as from 1990 ie. 35% to 39% in 1991. In this case, therefore, a growth trend could be predicted with United Nigerian Plc. Arewa Textiles Plc had fluctuating returns. It had 46% in 1987 and declined to 37% in 1988, rose to 54% in 1989 but declined to 46% in 1990 and 48% in 1991. On the whole, while United Nigerian Textiles Plc had higher returns in the first two years Arewa Textiles Plc had also higher returns in the last three years.

4.4.2 Profit Margin On Sales (%)

Table 4.10

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	7	4	9	4	4
United Nigerian Textiles Plc (Consolidated)	7	6	6	5	4

SOURCE: Computed by the Researcher

Profit margin on sales measures the profit per ₦1.00 of sales. From the above table, it is clear that Arewa Textiles had fluctuating ratio. From 7% in 1987 to 4% in 1988 and rose to 9% in 1989 but remained constant for the last two years. United Nigerian Textiles Plc with its subsidiaries had declining ratios. From 7% in 1987 it went down to 4% in 1991. This shows a declining trend.

4.4.3 Return on Total Assets (%)

Table 4.11

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	12	13	15	13	16
United Nigerian Textiles Plc (Consolidated)	10	10	8	14	13

SOURCE: Computed by the Researcher

This ratio measures the effectiveness with which a firm has employed its total assets. The greater the ratio the better for the firm.

As could be seen from the table, apart from 1990 when United Nigerian Textiles Plc had a return of 14% which was higher than Arewa Textiles Plc, Arewa Textiles Plc had better returns in all the years and showed a growth trend. It is therefore easier to predict that Arewa Textiles Plc had a better future than United Nigerian Textiles Plc. The ratios for United Nigerian Textiles Plc with its subsidiaries fluctuated over the years.

4.4.4 Return on Equity (%)

Table 4.12

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	27	17	26	19	19
United Nigerian Textiles Plc (Consolidated)	39	45	12	12	15

SOURCE: Computed by the Researcher

This ratio measures the rate of return on the shareholders' investment. The higher this ratio the higher the profitability and the greater funds available to shareholders. The ratios for the two companies over the years fluctuated. Arewa Textiles had 27% in 1987, declined to 17% in 1988 and rose to 26% in 1989 but remained constant in the last two years. It is therefore difficult to predict whether the result would be better or worse in the future. For United Nigerian Textiles Plc (Consolidated) the return increased from 39% to 45% in 1988, remained constant in 1989 and 1990 and rose again to 15% in 1991. It is however probable that the future will be better.

4.5.0 **Shareholders' Investment Ratios**

4.5.1 Earnings Per Share (Kobo)

Table 4.13

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	126.00	88.00	135.00	87.00	95.00
United Nigerian Textiles Plc (Consolidated)	14.44	21.94	33.39	34.14	48.55

SOURCE: Computed by the Researcher

Though Arewa Textiles Plc had fluctuating earnings per share, it had higher ratios than United Nigerian Textiles Plc in all the years. It shows that greater earnings are available to Arewa Textiles Plc's shareholders. It should be noted that the result of United Nigerian Textiles Plc showed an increasing trend. This goes to show that the future will continue to be better. Prediction of future growth is possible.

4.5.2 Dividend Per Share (Kobo)

Table 4.14

COMPANY	YEAR				
	1987	1988	1989	1990	1991
Arewa Textiles Plc	50.00	40.00	33.00	20.00	30.00
United Nigerian Textiles Plc (Consolidated)	8.33	10.41	20.83	20.83	25.00

SOURCE: Computed by the Researcher

Just like the preceding table (EPS) the dividend per share declared by Arewa Textiles Plc was higher than United Nigerian Textiles Plc's (Consolidated) in all the years. While there was fluctuation in the dividend per share in the case of Arewa Textiles Plc, there was a steady growth with United Nigerian Textiles Plc. The shareholders in United Nigerian Textiles Plc and its subsidiaries would not be wrong to predict a better future based on the growth trend exhibited by the above table.

CHAPTER FIVE

5.0 SUMMARY, RECOMMENDATION AND CONCLUSION

5.1.0 Summary

This study has amply demonstrated and provided some information about the operations and performance of Arewa Textiles Plc and United Nigerian Textiles Plc with its subsidiaries over a period of five years (1987-1991) by means of financial ratio analysis. This study considered a total of fourteen ratios under five broad groups such as liquidity ratios, debt management ratios, Activity ratios, Profitability ratios and Shareholders Investment ratios. In this wise, the ratios of these companies were considered individually and compared against each other.

In the course of analysing the data in Chapter Four the following were discovered.

(a) In liquidity ratio, a good or standard current asset ratio is 2:1 but as seen from the table in chapter Four, the two companies had current asset ratios that were far below the minimum cut-off. This is an indication that the two companies had low current assets throughout the period under review hence the low current asset ratio. However, Arewa Textiles Plc was better off than United Nigerian Textiles Plc throughout the period.

(b) The quick ratios for the two companies fluctuated over the period and were also below the ideal standard of 1:1. However, United Nigerian Textilies Plc with its subsidiaries had higher quick asset ratio throughout the period though it started declining as from 1989. If the ratio is too low it is a clear indication that the company may find it difficult to meet the maturing short term obligations.

(c) The debt ratios for the two companies fluctuated over the period. United Nigerian Textiles Plc had higher ratios in the first two years but declined in the third year to 57% and rose to 67% in the last year. That of Arewa Textiles was high in the first year and thereafter fluctuated. The fact that the two companies had ratios in excess of 50% means that there were more short term debts. Creditors will however prefer a low debt ratio because the lower the ratio the greater the cushion against their losses in the event of any fold up.

(d) Arewa Textiles did not have long term debt throughout the period therefore its debt-equity ratio was zero. However, United Nigerian Textiles had but with low debt equity ratio. The highest ratio shown was in 1988 of 71% and thereafter started fluctuating. The least ratio was 11% in 1991. Usually high debt-equity ratio indicates large amount of fixed assets and stable cash flow while less capital intensive firms have low debt-equity ratio.

(e) United Nigerian Textiles Plc with its subsidiaries had the highest stock turnover ratios throughout the period. The best year was in 1989 with stock turnover of 4.07 times. Arewa Textiles Plc also recorded its best stock turnover in 1988 with a ratio of 2.81 times. United Nigerian Textiles Plc was better off in terms of stock turnover. Too low inventory turnover indicates low inventory management and high ratio indicates low level of inventory and frequent stock-outs.

(f) Arewa Textiles Plc had better average collection period. The highest ever recorded was in 1987 of 13 days. United Nigerian Textiles Plc with its subsidiaries had its ratio as high as 103 days in 1988 and lowest (9 days) in 1991. This shows that Arewa Textiles Plc had the opportunity of realising its cash after sales earlier than United Nigerian Textiles Plc.

(g) While the operating assets of Arewa Textiles Plc was increasing year after year that of United Nigerian Textiles Plc was fluctuating. In all the years Arewa Textiles Plc was better off. This indicates that some fixed assets were invariably under-utilised by United Nigerian Textiles Plc with its subsidiaries. The worst fixed asset turnover recorded by United Nigerian Textiles Plc was 1.89 times in 1989.

(h) The total asset turnover for both companies fluctuated throughout the period but with Arewa Textiles Plc having better result, that is, higher total asset turnover ratio. This shows that Arewa Textiles Plc utilised its assets more efficiently.

(i) The two firms had fluctuating returns on capital employed. The highest return recorded by Arewa Textiles Plc was 54% in 1987 and the lowest return of 37% in 1988. On the other hand, United Nigerian Textiles Plc had its highest of 65% in 1988 and least return of 19% in 1989. Comparatively, apart from 1987 and 1988, Arewa Textiles Plc had better returns on capital employed.

(j) The profit margin on sales for the two companies fluctuated greatly. The highest return for Arewa was 9% in 1989 while that of United Nigerian Textiles with its subsidiaries was 7% in 1987.

(k) The return on total asset ratio for Arewa Textiles Plc was better in all the years apart from 1990 when it had 13% and United Nigerian Textiles Plc had 14%.

(l) While United Nigerian Textiles Plc had the best return on equity in the first two years, Arewa Textiles Plc had the best return in the last three years.

(m) Arewa Textiles Plc had higher earnings per share throughout the five year period. The dividend per share for Arewa Textiles Plc was also higher in all the years except in 1990 when United Textiles Plc declared 20.83 Kobo against 20.00 Kobo declared by Arewa Textiles Plc.

5.2.0 <u>Recommendations</u>

It was found out in the course of analysing all the data at my disposal that the firms selected had some financial problems occasioned by one reason or the other. In view of this development the Researcher has deemed it pertinent to recommend the following solutions :

(1) Remedies for TOO Low Liquidity Ratios

(a) Both firms had very low current asset and quick ratios. They should therefore increase their current assets by at least 100% more than their current liabilities.

(b) The two companies should reduce their current liabilities to enable them to increase their liquidity ratio.

(2) Remedies for too low Level of Stock

(a) Both companies to have qualified personnel in their purchasing departments. This will enhance the purchase of right quantity and quality of raw materials at the right time and price.

(b) The use of right machinery should be encouraged.

(c) The firms should develop and use appropriate economic order quantity for their raw materials.

(d) Continuous production should be encouraged to avoid future shortages of finished products which can result to losses of profits.

(3) Remedies for Excessive Operating Assets

As was seen in Chapter Four of this study the two companies either had problem of under-utilisation or excessive existence of the operating assets in one year or the other.

In this regard, therefore, the following recommendations could be used singularly or jointly.

(a) The two companies should sell off all the idle fixed assets including the unused and obsolete equipment and machinery.

(b) They should cut down the investment in operating assets. By so doing funds would be released and used elsewhere.

(c) The firms should increase their level of production if possible.

(d) Finally, they should lease or borrow their idle fixed assets to generate more funds.

5.3.0 Conclusion

One of the most crucial managerial roles is that of decision making in an organisation. This decision making is done at different levels of all the functional departments of the organisation. One of the most important decisions so made in an organisation is therefore that of financial decision. Because of this importance attahced to financial decisions so many tools and techniques have been applied by finance managers as yardsticks for making the best possible decisions. The likely question that has arisen from this is, which are the most accurate and reliable techniques for financial decision making?

Having regard to the previous researches done in this area and the result obtained in the preceding chapter I am of the view that financial ratio analysis can be used to evaluate corporate performance and predict their future growth. Going by this, I do not hesitate to recommend to the managements of these selected textilie companies to embrace the concept of financial ratio analysis in evaluating the past and predicting future performances of their organisations. This will go a long way to strengthening their financial bases in both short and long runs.

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