Performance of goldman sachs and financial ratio analysis

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Conventionally the Bank performance is evaluated by analysis of the financial ratios. However, despite of quite a few number of ratios being calculated, a sculpt that completely convinces the analysis of requirements and bank operations' efficiency evaluation is yet to be developed. Hence for these reason, the financial ratio analysis is balance with unlike eminence evaluations, with characteristics such as organization quality, equity structure, spirited position and others which are incorporated in the concluding assessment.

In this piece of work we are going to evaluate overall performance of Goldman Sachs and critically analyse how financial ratios are used to evaluate banks performance.

The Goldman Sachs Group, Inc. is a American investment banking and securities organisation which slot in global investment banking, securities, investment management, and erstwhile financial services principally with institutional clients. Goldman Sachs was founded in the year 1869 and its headquarter is at 200 West Street in the Lower Manhattan area of New York City. It has additional offices in major international financial hubs. The Goldman Sachs offers mergers and acquisitions advice, underwriting services, asset management, and prime brokerage to its clientele, which include corporations, governments and individuals. The Goldman Sachs also engages in proprietary trading and private equity deals, and is a primary dealer in the United States Treasury security market (Goldman Sachs Website).

Bank Internal Performance Evaluation

Strategic planning

Goldman Sachs' ability to address and tap into important economic and financial trends through roles such as advisor, financier, market maker and asset manager are critical for fulfilling their mission to help spur growth and perform strongly as a firm.

Technology

Technology is a core part of GS product offering and client experience. GS ability to respond quickly and effectively to address its clients' needs with customized systems, products and services helps differentiate the firm. A technological advantage for GS is that they have only one central risk system, which is partially a byproduct of not having done multiple, major acquisitions that often require merging and retrofitting platforms.

Personnel development

The success of the GS's efforts are measured by how effectively their people act. Over time, effective training and development have enrich their corporate culture and strengthen the values of client service and focus on reputational risk management. Recognition includes compensation, promotion, assignments and mobility opportunities. They have made it clear the link between the behaviour expected of its people and the recognition used to encourage it. This is critically important because it signals broadly the way GS expects its people to behave and conduct business (Goldman Sachs Annual report 2010).

Bank External Performance Evaluation

Market share

GS has frequently performed above the market despite worsening economic conditions. Since the 2008, the company has outpaced the market enough to draw public admiration. With strong profits and expected strong returns, the company has set aside $500M to invest in small businesses. These efforts are a combination to both improve the economy and their public image.

Regulatory compliance

The Dodd-Frank legislation and new capital and liquidity requirements under Basel 3 are two of the more significant outcomes from the recent focus on enhancing financial stability. Given regulatory implementation is only just beginning, and unclear on how the new rules will ultimately impact the industry. The broad contours of new regulation, however, are clear: improve the safety and soundness of the global financial system, increase the

transparency of derivatives markets, limit certain investing activities and reduce the consequences of a failure of a large financial institution.

Public confidence

Goldman Sachs announced in May 2010 that it formed a Business Standards Committee to reshape its business practices and mend its reputation. Chief Executive Lloyd Blankfein said at the time that “ there is a disconnect between how we view the firm and how the broader public perceives our roles and activities.” GS’s shareholders, BoD’s, clients and customers have supported Mr. Blankfein through all the crisis and this shows their faith in bank (Goldman Sachs Annual report 2010).

4. 0 Analyzing Bank Performance with Profit Ratios

Goldman Sachs financial performance was better in 2009 than 2010 and Q4 2009 was the best quarter since the recession.

4. 1 ROE

Return on equity (ROE= net income after taxes/total equity) reveal GS capability to produce profits from shareholders’ equity (further referred as net assets or assets minus liabilities). In other words, ROE shows how effectively a company uses the shareholders money.

As seen in graphical representation above, it is clear that Goldman Sachs is tendering a lower return on shareholders’ equity as compared to year ended in2009. The ROE of GS for the last year was 18. 93% as compared to 10. 08% this year. There has a been a significant decrease in the ROE which suggests GS is not utilising shareholders money properly. GS return on

equity has declined substantially due to deleverage and is only marginally higher than its current cost of capital.

4. 2 ROA

Return on assets (ROA = net income after taxes/total assets) is how resourcefully a firm uses its assets. From the formula it is quite obvious that higher the ratio, the company is performing more efficiently and thus is generating more profits. A low ROA with enormous assets designate that the firm is handling its asset at a poor rate.

As seen in graphical representation above, it is seen that Goldman Sachs has provided a lower ROA of 0. 91% this year over 1. 58% last year.

There is one key differentiation between ROE and ROA and it is debt. In absence of debt, the shareholder’s equity is same as total assets of the firm which means that in this case, ROE and ROA are identical. Now if the firm come to a decision to take a loan, ROE exceeds ROA. A elevated ROE does not always guarantee a extraordinary performance of a firm. Incidentally, ROA is then a healthier pointer of the financial performance of a firm.

With a high ROA and manageable debt, if ROE is also high it means that the company is generating decent profits using shareholder’s money. But if ROA is low and there is huge debt carried by the company, even a high ROE can only be a misleading figure.

4. 3 Net Interest Margin

4. 4 Leverage ratio – Debt to Equity Ratio

4. 5 Decomposition of ROE – DuPont Analysis

As revealed in Appendix B, The ROE of a bank is dependent on a various factors and thus change in any one of these factor can affect the rate of return on shareholders' equity of the bank. As Net Income is the main source to calculate ROE in conjunction with the shareholders equity in the bank, every alteration in the Income and Expense of the bank openly affects the net income and thus influence the ROE of a bank.

The detailed DuPont analysis of Goldman Sachs for year 2010 is presented in Appendix B. The ROE is decomposed as follows wrt dupont identity.

Now assuming that changes are made in Income or Expense levels of the Goldman Sachs, its effect will be seen on ROA and ROE. Let us consider a case where the Interest Expense for Goldman Sachs goes down by 10% and there are no changes in its Interest Income, following are the effects on ROA and ROE of the bank.

Scenario 1 : -5% change in interest expense

Change

Values after change

Interest Expense

-10%

6125. 4

Interest Income

0%

12309

Effect on NI

6680. 6

39841. 6

Effect on ROA

+0. 07%

0. 99%

Effect on ROE

+0. 88%

11. 68%

A few other situations with amendment in Total Non-interest Income and expenses and their outcome on the ROA & ROE of bank are given away in the chart below.

Scenario 2 : -5% change in non-interest expense

Change

Values after change

Total Non-interest Income

-5%

31975. 1

Effect on NI

-1682. 9

37478. 1

Effect on ROA

-0. 19%

0. 73%

Effect on ROE

-1. 46%

8. 62%

Scenario 3 : +10% change in non-interest expense

Change

Values after change

Total Non-interest Expenses

10%

27962

Effect on NI

-2542

3160

Effect on ROA

-0. 31%

0. 27%

Effect on ROE

-4. 44%

3. 78%

Bank Performance Evaluation Based on Economic Profit

5. 1 Risk-Adjusted Return on Capital (RAROC)

In risk- adjusted return on capital the capital is allocated for two vital motives: (1) risk management and (2) performance evaluation.

In support of risk-management rationale, the banks most favourable capital structure can be establish by allocation of capital to individual business units. This course of action entails assessing the amount of the risk

(volatility) each business unit chip in to the total risk of the bank and hence to its overall capital requirements.

Now, for performance-evaluation function, RAROC structure allocate capital to business units as part of a procedure for shaping the risk-adjusted rate of return and, eventually, the economic value added of each business unit. The EVA of every and each business unit is it's adjusted net income minus the amount of equity capital allocated to the unit times the required return on equity. The purpose is to compute a business unit's input to shareholder value and so to provide a source for effective capital budgeting and incentive compensation at the business-unit level.

RAROC is calculated by dividing risk-adjusted net income by the total amount of economic capital assigned which is dependent on the risk calculation. Risk-adjusted net income is calculated by taking the financial data allotment to the bank and fine-tuning the income statement for expected loss. A further modification is also required to take into account the effects on the net interest margin because the attention is moved from book profitability to economic profitability.

Thus RAROC = Risk adjusted income / Allocated Capital

RAROC for 2010 of Goldman Sachs therefore comes to 2. 24 %. Let us consider some scenarios where the risk adjusted income for Goldman Sachs are changed by {-2%, +2%, -5% & +5%}, The effect on its RAROC is represented as below.

Change in Risk Adjusted Income

2 %

+ 2 %

5 %

Effect on RAROC

2. 20 %

2. 29 %

2. 13 %

Economic Value Added (EVA)

EVA (Economic Valued Added) is a present day financial dimension instrument which concludes whether a business is earning greater than its true cost of capital. EVA stands out apart from ROA & ROE which are most accepted measures of bank performance. This is because it includes cost of equity capital employed. On the other hand, net banking income and the efficiency ratio, also, do not consider the cost of equity capital employed. Therefore, these ratios possibly will propose a bank's performance as healthy but in fact it could be deteriorating its value to its shareholders. EVA is essentially a tool that focuses on maximizing shareholder wealth.

EVA = Adjusted earnings – Opportunity cost of capital

{Net operating Profit after Taxes}

{Cost of Equity X Equity Capital }

With an aim of creating values, the return on invested capital (ROIC) for a bank must be greater than cost of capital. So, the EVA can be possibly increased in quite a few ways, by:

1) Increasing Net operating Profit after Taxes;

2) Lowering the Cost of Equity and

3) Reducing Equity Capital

Conclusion

Year on year Goldman Sachs revenues have descended by 11. 04% from $51. 67bn to $45. 97bn. This along with an increase in the cost of goods sold expense has contributed to a reduction in net income from $13. 39bn to $8. 35bn, a 37. 59% decrease. In 2010, Goldman Sachs did not generate a significant amount of cash. Cash Flow from Financing totalled $7. 84bn or 17. 05% of revenues. In addition the company used 6. 16bn for operations while cash used for investing totalled $185m. Goldman results were also dragged down by a $465 million one-time expense to cover a U. K. payroll tax and a $550 million outlay to settle SEC charges that it favoured certain clients over others.