

Financial management case study sample

[Business](#), [Company](#)



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Introduction

United Bank for Africa Plc (UBA) is one of the leading financial service institutions in Nigeria and West Africa, listed on the Nigerian Stock exchange, UBA is rapidly evolving into Pan African Service institution. Several ratios were applied on the financial data of the company and there were areas where the company performed well while in other areas there are valid concerns.

Financial Analysis

There are various ratios that showed that the company had improved in terms of profit in the period 2007 to 2008. The following ratios showed positive growth.

Net Profit Ratio: Net profit ratio increased from a figure of 27. 77% in 2007 to 35. 48% in 2008. This shows an increase of 21. 73% over the period under review.

Net Profit Ratio = Net Profit X 100

Net Sales

Year 2008 = 40,002 X 100 = 35.48%

112,744

Year 2007 = 19,831 X 100 = 27.77%

71,412

Going by the outcome of the ratios computed above, the bank's rate of capital retention was very impressive, entails that the bank has some non-interest/zero-cost.

There's is an improvement in the profitability of the firm as seen by the margin computed. This could be as a result of good management to shareholders. A reduction in cost of operation which lead to high profit.

Dividend Cover Ratio: In 2007 the company paid out 11.48% of its earning in dividend while it paid out 12.2% of its earning in 2008. The company can therefore be said to retain 88.52% and 87.8% of its earnings over the two years period.

Dividend Cover Ratio: Earning Per share

Dividend Per share

Year 2008 =

305 = 12.2

25

Year 2007 =

241 = 11.48

21

In analysing the financial ratios of the Bank of Africa financial statements, there are several issues of concern that emerge. Despite the positive growth in the net and gross profit for the period 2007 to 2008, the current ratio reduced over the same period. It is important to have a current ratio of between 2: 1 (Adams & William, 1998), It is a measure of the company's liquidity and how prepared it is to settle its short term obligations using its liquid assets. The current ratio of the company is as follows:

Current (Working Capital) Ratio: Current Assets

Current Liabilities

Year 2008 = 720, 313

= 0.54 : 1 times

1, 330, 947

Year 2007 = 545, 520

= 0.58 : 1 times

935, 401

The bank needs to analyse the liquidity of its assets and how it can liquidate some of its long-term assets to increase the bank's liquidity. It is important

for the company to have good cash flow. Lack of adequate liquidity may cause bottlenecks in some of the bank's tactical operations. The company needs to have a specific skilled person look at the working capital ratios of the company. There is need for effective working capital management. This refers to the management of the current liabilities and current assets of the company. The current assets of a company include the cash and short-term funds, cash due from other financial institutions and treasury bills and government bonds. The current liabilities of the bank on the other hand are the deposits and current accounts and managed funds. The financial statements show there was a substantial increase in the deposit and current accounts. The amounts of this liability should be matched with higher investment in the current assets. It is not good for the company to take all the money to long-term capital projects or purchase of fixed assets. Many companies concentrate on their quarterly results and other market issues instead of proper working capital management. It is important for the business to realise that the legal environment, the information systems and customers can severely affect the liquidity of the business.

In a bank, the customers with current accounts are aware that they can withdraw their money any time. In the event, most of them come to withdraw; it will not project a good image for the bank when it becomes known the company has liquidity problems. In order to improve the working capital ratio, several steps can be taken. First of all there needs to effective cash forecasting conducted for the organisation. What are the company cash needs the whole year in terms of payments and what are the expected receipts? The forecasting should also put into consideration unforeseen

events, the loss of certain critical clients and delays by customers to pay in the event of adverse market cycles. It is good to have cash for contingency purposes.

There should be efficient risk management in the business. This can only be done when there is a realistic or objective awareness of the capabilities of the working capital of the business. Being a global group, there needs to be efficient use of working capital. There needs to be coordination between the different countries in that cash that is not being utilised in a certain branch can be taken to another branch that is in need. For this to occur, the group should have great information systems, linkages and treasury management. The bank also needs to look at the settlement of its creditor obligations in comparison to how its debtors pay up. The bank should not be in a position where all its loans are long-term while the credit facilities are mostly short-term. This will also cause a constraint in the working capital.

Management will also have to consider the options of external or internal funding when faced with finance issues especially during economic downturns, companies can look internally by adjusting both fixed and variable by reflect the personal strengths of those appointed as well as their deep talent through downsizing, negotiating pay cuts with employees, produce more of cost effective but lucrative products (Aminu, 2007). In order to further improve the company's liquidity, the bank should reduce its variable cost like wages. Considering that the provision for tax increased drastically; the bank should ensure that tax payable is reduced and consider fixed cost like rent can be shared with other firms to eliminate overpayment (Remi, 2005, p. 420). Taking advantage of this fund will go a long way to

reducing finance charges in the bank's profit & loss account (Institute of Chartered Accountants of Nigeria, 2006, P. 20). The bank should limit investment in habitation and place assets on sale to be able to improve liquidity position of the firm.

The other ratio that raises concern is the debt ratio of the company. It has been observed that the debt ratio in 2007 was 85.06% however in the year 2008, the debt ratio rose by 2.9% to settle at 87.63%. The debt ratio is the percentage of the total debt in relation to the total assets. It is used to show which percentage of the company's assets have been financed through debts (Bathory, 1997).. The debt ratio was calculated as follows:

$$\begin{aligned}\text{Debt Ratio} &= \frac{\text{Total Debt}}{\text{Total Assets}} \\ &= \frac{\text{Current Liability} + \text{Long Term Liabilities}}{\text{Total Assets}}\end{aligned}$$

Total Assets = Fixed Asset + Current Asset

$$\text{Year 2008} = \frac{1,331,938 + 157}{1,520,093} \times 100 = 87.63\%$$

1,520,093

$$\text{Year 2007} = \frac{937,525 + 157}{1,102,348} \times 100 = 85.06\%$$

1,102,348

The company needs to look at the amount it owes other companies and repayment options that are available. It needs to reduce its debt.

Considerations in Capital Investments by the Company

In considering a new investment, the management should evaluate the return of the capital that will be invested. There are several methods that a company can use to analyse an investment such as the payback method and the cash discounted method. It is important that the cash flows received over the project life when discounted using the appropriate discount factors exceed the initial investment that the management put in. In the year 2009, the return of capital employed should have a positive growth as was reflected in the year 2007 and 2008 as follows:

Return on Capital Employed: $\text{Profit B/4 Interest \& Tax} \times 100$

Capital Employed

Year 2008 = $54,637 \times 100 = 28.9\%$

189,146

Year 2007 = $28,615 \times 100 = 17.14\%$

166,949

Deciding whether to make new investments for the organisation would require some very significant pointers which form the basis for every business investment decision is the profitability of the prospective investment. The profitability of any investment may be considered in terms of short-run or long-run. Also, the profitability of any investment is linked to other factors such as market prospects, ability to operate an enterprise at an optimum cost etc. In order to make a rational and result-oriented decision on the above

mentioned investment options, the company needs to evaluate some qualitative and quantitative factors.

Qualitative factors: The bank should assess the banking habit of targeted geographic areas (for instance rural communities) so as to decide whether it will be profitable to establish branches in those areas. The sophistication of the customer's (both potential and existing customers) needs may determine the investment whether investments should be channelled to IT development. In addition, as part of the qualitative factors, the bank should evaluate the general financial regulations put in place by the government. Where such policies do not engender stability of the financial sector, then it will be unwise to make further investment (Block & Hirt, 1992).

Quantitative Factor: The bank may need to evaluate the cost of obtaining additional capital needed to engage in new investments. It also needs to evaluate the various financing mix available to it. While some companies may prefer equity financing, others may prefer the use of external finance (Chuke, 2001, p. 99). The determination of cost of capital involves the use and analysis of some investment appraisal tools such as :

Dividend Ratio : This is used to determine Earnings per share to Dividend per share. The bank needs to raise funds to be able to finance new investments, such funds cause the equity capital to increase the present ordinary shareholders

Payback Period (PBP) : This is used to determine the length of time it takes an investment's cash inflow to repay its initial outlay. However, the bank has to establish its maximum payback period target for the planned investment.

Debt capital : This is important since the company is highly financed with more of equity holders (Bear & Maldonado-Bear, 1994).

Conclusion

Financial ratios are tools used in analyzing the financial health and performance of companies. They provide a good indicator on the performance of businesses. UBA Bank is on a great path and should work towards improving its working capital and debt ration. This will cause it to be financially healthy and a great future even in times of turbulence.

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