

## **CHAPTER ONE**

### **INTRODUCTION OF THE STUDY**

#### **1.0 Background of the study**

Although performance measurement systems can play a key role in communicating, evaluating, and rewarding the achievement of strategic objectives, .....One of the primary criticisms of performance measurement systems is that they are generally limited to financial indicators, thereby focusing the organization on past performance and encouraging a short-term view of strategic objectives (e.g., Eccles, 1991; American Institute of Certified Public Accountants, 1994; Deloitte & Touche, 1994).

Investors and others stakeholders who have tremendous interest in every business, evaluate the business success and make quality investment decisions based on the financial performance of such entities. Investors will have some level of assurance in the soundness of the management of their investments which will be the bases for further capital investments and can focus most of their efforts on how to improve their capital management in a different economic environment.

Finance is life blood of the business. The financial management is the study about the process of procuring and judicious use of financial resources is a view to maximize the value of the firm. (Babasab Patil). Therefore managers try to present financial reports that show the effectiveness of their performance in their quest to securing further funds from shareholders.

In this project, the researchers are trying to provide assistance to investors, creditors and other stakeholders who are concerned by showing them how to analyse the performance of banks using Asante Akyem Rural Bank Limited as a case study.

Financial statement analysis is a method used by interested parties such as investors (current and potential), creditors and management to evaluate the past, current and project conditions and performance of the firm and use to compare the strengths and weaknesses in various firms.

Ratio analysis is the most common form of financial analysis .It provides relatives measures of firm's conditions and performance. Financial statement discloses the internal structure of the firm. It indicates the existing relationship between sales and cash income statement account.

It shows the mix of assets that produce income and the mix of the source of capital, whether by current or long term debt or by equity funding. Financial ratios analysis is widely used to summarize the information in a company's financial statement in assessing its financial health.

In countries where financial instability is rife and financial intuitions are becoming popular, when it comes to investing, the sound analysis of financial statements is one of the most important elements in the fundamental analysis process. At the same time, the massive amount of numbers in a company's financial statement can be bewildering and intimidating to many investors, creditors and those who are concern with the financial statement. However, through financial ratio analysis, the study would be able to work with these

numbers in an organized fashion and present them in a concise form for easily understandable to both the management and other stakeholders.”..... ratios constructed to judge comparative performance. Financial ratios serve a similar purpose, but you must know what is being measured to construct a ratio and to understand the significances of the resulting number” (Stanly B. Block and Geoffrey A. Hirt 1994 Page 51)

## **1.2 Research Problem**

Many firms, institutions and businesses have knowledge about accounting ratios, analysis and its interpretation. Some businesses make use of these ratios but apply them wrongly, others also use the right method but give wrong interpretations to it and most firms do not apply at all. It is because of the above problems that prompted the researchers of this study to write about the use of accounting ratio and its interpretation.

## **1.3 Objective of the Study**

The objectives of this study are to:

- To assess performance of a bank by using financial ratios.
- To identify suggestions that could be applicable on the performance of the firm

## **1.4 Research Question**

This section or study discusses questions that are formulated in such a way that answers found to them would serve as the solution to the research problems. The study seeks to answer the following questions:

- How can financial Ratios be used to assess performance of Asante Akyem Rural Bank Limited?
- What are the suggestions that could be applicable to an organization in assessing performance?

### **1.5 Significant of the study**

Financial statements provide an overview of a business financial condition in both short and long term. All the relevant financial information of a business enterprise present in a structured manner and in a form easy to understand is called the financial statements.

Therefore these financial statements are very useful for the stakeholders, as they obtain all insight information. In assessing the significance of various financial data, experts engage in ratio analysis, the process of determining and evaluating financial ratios. Financial ratios are only meaningful when compared with other information since they are most often compared with industry data, ratios helps an individual understand a company's performance relative to that of competitors; they are often use to trace performance overtime. Ratio analysis can reveal much about a company and its operations. However, there are several points to keep in mind about ratios. First financial ratios are “flags” indicating areas of strength and weakness. One or even several ratios might be misleading but when combined with other knowledge of company's management and economic circumstances, ratios analysis can tell much about a corporation.

Addition, a ratio is meaningful when it is compared with some standard such as ratio trend, a ratio trend for the specific company been analyzed, or a stated management objectives.

### **1.6 The scope of the study**

The study will be limited to the financial statements of Asante Akyem Rural Bank. In the case of achieving the objectives of the study, the researchers will undertake an interview with the various stakeholders (the staffs of the bank) to obtain their views about the application of financial ratio within the organisation.

### **1.7 Limitation of the study**

The limitations of the study spells out the constraints that the researcher faced during the study which are time, finance, attitude of respondents and source of information.

- Time: The researcher's work was carried out concurrently with the courses offered. The project therefore was competing with other academic activities for scare time.
- Finance: The research work is financed by the researcher alone without any financial support from both the school and the organization been researched into.
- Attitude of respondents: some of the respondents feel uncomfortable and reluctant to give and answer some salient questions that can help the research work during interview and the answering of questionnaires impeded the progress of the research.

- Sources of information: the financial statement, books and materials as basis for the research were sometimes difficult to get and sometimes not sufficient to lay hands on, to get the appropriate information needed for the research.

## **1.8 Organization of the study**

This study discusses accounting ratios, analysis and interpretation of financial statement in a business organisation and is divided into five chapters.

Chapter one of this study talks about the introduction, problem statement, research questions, purpose of the study, justification of the study, limitations of the study and the organization of the study.

Chapter two discusses literature review, Definition of accounting ratio, benefits, limitations, financial performance, financial ratios as measurement indicator, ratio analysis for investment, ratio analysis for business management, nonfinancial performance indicators, liquidity ratios aid financial management, corporate governance on financial ratios, rural banks and their roles, the profile of Asante Akyem Rural Bank Limited and the role of Asante Akyem Rural Banks Limited to its catchment areas.

Chapter three deals with the methodology, these include research design, population sample and sample procedures, data collection techniques, reliability of instruments and data analysis.

Chapter four talks about the presentation of data and the discussion of results, This includes computation of profitability ratio results, computation of activity ratio

results, computation of liquidity ratio results, computation of gearing ratio results, computation of investor ratio results and Summary of the respondents on how the bank applies Accounting Ratios.

The final chapter, which is chapter five, discusses summary of findings, conclusions and recommendations.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

Ratio simply means one number expressed in terms of another. A ratio is a statistical yardstick by means of which relationship between two or various figures can be compared or measured.

#### **2.1 Definition of Accounting Ratios:**

The term "accounting ratios" is used to describe significant relationship between figures shown on a balance sheet, in a profit and loss account, in a budgetary control system or in any other part of accounting organization. Accounting ratios thus shows the relationship between accounting data.

Ratios can be found out by dividing one number by another number. Ratios show how one number is related to another. It may be expressed in the form of co-efficient, percentage, proportion, or rate. Ratio sometimes is expressed in the form of rate.

#### **2.2 Benefits of Ratios Analysis:**

Ratio analysis is an important and age-old technique of financial analysis. The following are some of the advantages / Benefits of ratio analysis:



1. Simplifies financial statements: It simplifies the comprehension of financial statements. Ratios tell the whole story of changes in the financial condition of the business
2. Facilitates inter-firm comparison: It provides data for inter-firm comparison. Ratios highlight the factors associated with successful and unsuccessful firm. They also reveal strong firms and weak firms, overvalued and undervalued firms.
3. Helps in planning: It helps in planning and forecasting. Ratios can assist management, in its basic functions of forecasting. Planning, co-ordination, control and communications.
4. Makes inter-firm comparison possible: Ratios analysis also makes possible comparison of the performance of different divisions of the firm. The ratios are helpful in deciding about their efficiency or otherwise in the past and likely performance in the future.
5. Help in investment decisions: It helps in investment decisions in the case of investors and lending decisions in the case of bankers etc.

### **2.3 Limitations of Ratios Analysis:**

The ratios analysis is one of the most powerful tools of financial management. Though ratios are simple to calculate and easy to understand, they suffer from serious limitations.

1. Limitations of financial statements: Ratios are based only on the information which has been recorded in the financial statements. Financial statements themselves are

subject to several limitations. Thus ratios derived, there from, are also subject to those limitations. For example, non-financial changes though important for the business are not relevant by the financial statements are affected to a very great extent by accounting conventions and concepts. Personal judgment plays a great part in determining the figures for financial statements (McLaney E, 2006).

2. Comparative study required: Ratios are useful in judging the efficiency of the business only when they are compared with past results of the business. However, such a comparison only provide glimpse of the past performance and forecasts for future may not prove correct since several other factors like market conditions, management policies, etc. may affect the future operations.
3. Ratios alone are not adequate: Ratios are only indicators they cannot be taken as final regarding good or bad financial position of the business. Other things have also to be seen.
4. Problems of price level changes: A change in price level can affect the validity of ratios calculated for different time periods. In such a case the ratio analysis may not clearly indicate the trend in solvency and profitability of the company. The financial statements, therefore, be adjusted keeping in view the price level changes if a meaningful comparison is to be made through accounting ratios. ( McLaney E, 2006 )
5. Lack of adequate standard: No fixed standard can be laid down for ideal ratios. There are no well accepted standards or rule of thumb for all ratios which can be accepted as norm. It renders interpretation of the ratios difficult.

6. Limited use of single ratios: A single ratio, usually, does not convey much of a sense. To make a better interpretation, a number of ratios have to be calculated which is likely to confuse the analyst than help him in making any good decision.
7. Personal bias: Ratios are only means of financial analysis and not an end in itself. Ratios have to be interpreted and different people may interpret the same ratio in different ways.
8. Incomparable: Not only industries differ in their nature, but also the firms of the similar business widely differ in their size and accounting procedures etc. It makes comparison of ratios difficult and misleading (McLaney E, 2006).

#### **2.4 Classification of Accounting Ratios:**

Ratios may be classified in a number of ways to suit any particular purpose. Different kinds of ratios are selected for different types of situations. Mostly, the purpose for which the ratios are used and the kind of data available determine the nature of analysis.

#### **2.5 Financial Performance**

In a study conducted by Collis and Jarvis (2006) on financial information and the management of small private companies in the U.K., the most useful sources of information are the periodic management account (i.e. the balance sheet and income statement), cash flow information and bank statements (of course bank statement are another form of cash flow information but generated externally). These sources of information are used by eight (80) per cent of companies and this demonstrates the importance of controlling cash, which

previous research ( Bolton, 1971, Birly & Niktari, 1995, Jarvis et al, 1996) suggest is critical to the success and survival of a small business.

In the same research eight-seven (87) per cent of small companies' prepared profit and loss accounts and seventy-eight (78) per cent, balance sheet. These key financial statements allow management to monitor profitability of the business as well as its net assets. Confirming the usefulness of cash flow information, the analysis shows that seventy-three (73) per cent use bank reconciliation statement and more than fifty-five (55) percent use cash flow statements and forecast. However, other competitive performance measures perceived in literature such as ratio analysis, industry trends and inter-firm comparison are not widely used. Collis and Jarvis (2002) then states that this may indicate that small companies experience problems in gaining access to appropriate benchmarks, but could also be the results of competitors filing abbreviated accounts which reduces the amount of information available for calculating ratio and making comparism. In addition, as many small companies operate in the service sector, they occupy niche markets and may be less concerned with competition than those in other markets.

Melse (2004), reports that ratio analysis provides an insight into the financial health of a firm by looking into it liquidity, solvability, profitability, activity and capital and market structure. Jooste (2004) investigates that many authors agree that cash flow information is a better indicator of financial performance than traditional earnings. Largay and Stickney (1980) and Lee (1982) show that profits were increasing, W.T. Grant and Laker Airways had severe cash flow problems prior to bankruptcy. Jooste (2004) further states that users of financial statements around the world evaluate the financial statements of companies to determine the

liquidity, assets activity, leverage, profitability and performance. Users of financial statements use traditional balance sheet and income statements ratios for performance evaluation. Therefore, along with traditional ratios, operating cash flow is also important when evaluating a company's performance (Jooste, 2004). Various literature states that the primary purpose of the cash flow statement is to assess a company's liquidity, solvency, viability and financial adaptability. According to Everingham et al (2003) operating cash flow ratios are indicators of performance. They determine the extent to which a company has generated sufficient funds;

- To repay loans;
- To maintain operating capabilities;
- To pay dividend; and
- To make new investments without using external financing, (Jooste, 2004).

Cash flow ratios can be used to answer questions on a company's performance since debt obligations are met with cash. Such an analysis will result in adequate lines of credit, unrestricted cash availability, debt maturity schedules with respect to financing requirements and the willingness to issue common equity. It will allow an analyst to examine a company's financial health, and how the company is managing its operating, investment and financing cash flows (Palepu et al, 2000). A lack of cash flow data has caused problems for investors and analysts in assessing a company's performance, liquidity, financial flexibility and operating capability (Figlewicz and Zeller, 1991). Cash flow may be viewed as the lifeblood of a company and the essence of its very existence (Rujoub et al, 1995). The cash flow

statements offer measures to evaluate performance. If cash flow information is useful but unused, the logical conclusion is that analysts are not analysing available data properly (Carslaw and Mills, 1991)

## 2.6 **Financial Ratios as measurement indicator**

The Net Profit to Capital Employed ratio mentioned measures the success of a company in using funds available to it. There are ratios to measure the company's:

- Financial health
- Operating performance
- Cash flows and liquidity

Under each category, there are multiple ratios that measure different aspects, or fine tune the measurements. For example, different profitability ratios measure profit margins at different stage, return on owners' funds and effective tax burden.

Categories of different ratios this study looked at include the following:

- a) [Profitability Ratios](#)
- b) [Liquidity Ratios](#)
- c) [Debt Ratios](#)
- d) [Performance Ratios](#)
- e) [Investment Evaluation Ratios](#)

## **2.7 Ratio Analysis for Investment**

Outside investors looking for long-term investment use financial statement ratio analysis to analyze the "fundamentals" of a company. Fundamentals are indicators that point to the potential for long-term success (or otherwise) of a company. Fundamental analysis is different from "technical" analysis that focuses on short-term price movements of a company's shares in the stock market.

Financial statement ratio analysis can help measure a company's:

- Profitability
- Financial structure and position
- Returns provided to shareholders
- Performance compared to peer companies

## **2.8 Ratio Analysis for Business Management**

Business managers inside the organization can do ratio analysis to quickly spot problem areas. The analysis might, for example, indicate cash flow problems. It can further reveal that the cash flow problems arise mainly because of slow collection of dues from customers.

Insider managers have access to much more information than what is available in financial statements. In the case of profitability ratios, for example, they have access to the detailed composition of the cost of goods sold. They can thus check which cost

element is leading to high costs. They can also analyze the performance of individual business units, and do it on a monthly basis or more frequently.

Financial ratio analysis is typically done to make sense of the massive amount of numbers presented in company financial statements. There are different categories of financial ratios that highlight different aspects of performance. Ratios reveal relationships that can help evaluate the performance of a company, so that investors can decide whether to invest in that company. Analysis can also spot a problem area of operation so that managers can focus on the area.

## **2.9 Profitability Ratios Measure Margins and Returns**

While profit margin ratios look at the margins that a company was able to generate, return ratios examine how well the company utilized available resources.

Published financial statements of companies disclose profits at different stages. Profitability ratios focus on these, and constitute just one category of financial ratios.

## **2.10 Profit Margin Ratios**

Profit margin ratios compare the four levels of profits mentioned in the previous section with the net sales or revenue amount. The ratios are typically converted into percentages for easy understanding.

- $\text{Gross Profit Margin} = \text{Gross Profit} / \text{Net Sales or Revenue}$
- $\text{Operating Profit Margin} = \text{Operating Profit} / \text{Net Sales or Revenue}$
- $\text{Pretax Profit Margin} = \text{Pretax Profit} / \text{Net Sales or Revenue}$



- $\text{Net Profit Margin} = \text{Net Profit} / \text{Net Sales or Revenue}$

There are no universal profit margins applicable to all businesses. Instead, the margins tend to vary from industry to industry and product line to product line. The value of profitability ratio analysis lies in:

- The ease with which historical performance can be compared. Thus, it is possible to compare this year's gross profit margin with last year's, and analyze the reasons for any variation. The findings from the analysis are likely to provide high value insights.
- The opportunity to compare the performance of different companies engaged in the same business. This peer comparison can provide an indication of how well a company is doing as against its competitors.
- Similarly, comparison can also be made against industry averages, though this can be less meaningful if the industry accommodates players with very different product lines.

## **2.11 Non Financial Performance indicators**

Implementation of Balanced Scorecard in banks and financial institutions is a very tricky thing as there is huge temptation to focus on financial indicators only. As known, banks, mortgage and insurance companies, credit unions and other financial institutions work with money to make more money. So, it is very easy to disregard non-financial indicators that, however, have a direct impact on financial performance of the above mentioned organizations. The last several decades saw a sharp increase in the number of commercial banks and financial institutions which caused a very tough competition in this market. The

traditional performance management systems turned out to be quite ineffective since very often they failed to meet specific requirements of financial organizations. This is where non-financial indicators can help. And that is why Balanced Scorecard system turned out to be a more effective tool to measure business performance of financial organizations and communicate operational management with strategic vision Kaplan and Norton (1992, 1996).

One of the key problems banks and other financial organizations faced in performance evaluation is focusing on internal processes, which is good in itself, but at the same time ignoring external environment that is changing all the time and thus endangering financial institutions. Another common mistake is ignoring intangible assets. In the modern age of information in intellectual resources and financial knowledge must be given due attention. So, as to implementation of Balanced Scorecard in banks and financial institutions. Balanced Scorecard measures key performance indicators in four perspectives: financial, customer, internal processes, learning and growth. It is difficult to say which perspective is the most important but it is possible to say that implementation of financial goals depends on success in the other three categories. Also, much depends on company strategy vision and strategic goals. Some banks may have a large customer base and should focus on internal processes while other financial institutions have to concentrate on attracting new customer and improving customer satisfaction in order to achieve financial goals, Kaplan and Norton, (1996).

## **The Four Perspectives in Financial Institution Scorecard**

### **1. Financial**

Although financial goals are the most important for financial institutions, focusing only on financial indicators will not represent everything happening to the organization. That's why due attention should be given to financial indicators, but at the same time one should remember that financial goals are achieved through implementation of other non-financial goals. The following are some basic financial strategic goals a bank or any other financial organization may pursue;

- a) Reduce costs. One of the main goals here may be reducing expenses that do not lead to generating of income. This is achieved by improving productivity, optimizing business processes etc. As a rule, this is a 2-5 year plan that has a step by step implementation system.
- b) Improve return on spending (ROS). ROS represents efficiency of managing company's funds. The ultimate goal is to create wealth. By engaging in high return activities a bank or any other financial organization increases the profit on spent funds.
- c) Increase revenues. This is about increasing the number of valuable customers, broadening relationships with the VIP customers through sale of new products and cross-selling of existing products.
- d) Reducing risks. This may be achieved by moving from net interest income to broadening of portfolio of fee based products. This will caution and protect the bank or a financial organization holmstrom, (1979), Banker and Datar, (1989).

## **2. Strategic Customer Objectives.**

- a) Improving the image of a financial organization in the eyes of customers. This simple goal has a direct impact on financial performance of an organization. More customers bring more money.
- b) Informing customers in a better way. A greater customers' knowledge of banking services will make it possible for bank employees and management better meet customers' needs.
- c) Eliminate mistakes in customer service. This refers to all operations and transactions as well as communication of customer with a bank.

## **3. Strategic Goals on Internal Processes**

- a) Innovation. This includes identifying needs of customers who represent high profitability and analyzing of their economic background. It is important to create new products, innovative financial services which are convenient for customers and cost efficient for the organization that offers them.
- b) Delivery of services. This is about cross-selling of products through motivated and proactive employees of a financial organization. Bank employees should listen to customer needs and educate customers on new services and products. In order to achieve this goal, employees of a financial organization should have strong relationships and regular communication with an

c) Service Excellence. A bank or a financial organization must understand that service excellence is imperative for survival in the market. This is a key to keeping relationships with customers and gaining competitive advantage in the battle for new customers.

#### **4. Strategic Learning and Growth Objectives**

a) Gaining competitive advantage is being much determined by extracting, manipulating and use of information. This process consists of two stages: gathering information, analyzing of information and determining what information should be used in decision making. And of course, it is imperative to improve methods of gathering and analyzing of information by introducing innovative Information Technology support systems.

b) Strategic jobs and competencies. This includes the ability to cross-sell the products by focusing on customer needs. In order to achieve this goal, employees should have a better understanding of company products and services, as well as understanding of financial markets in general.

c) Compensation, reward and accountability system. Only properly motivated employees would give the best work results. Balanced Scorecard should be used to offer additional motivation for employees who manage to fulfill tasks and implement goals at their workplaces. These goals might be different, from attracting new customers and selling new products to offering innovative ideas and techniques.

d) Focusing on resources. Allocation of resources should be in that areas which claim to offer the highest profitability, and setting priorities should be based on this principle. A few

words must be said about information systems. We are living in the age of progressing IT technologies. We have already had the chance to appreciate innovative banking and financial services like mobile banking, Internet banking, getting free insurance quotes, loan and deposit calculators etc. Without any doubt, these new services and products increase competitive advantage of a financial organization if properly applied in any of the four perspectives Holstrom and Milgrom, (1991).

### **2.12 Liquidity Ratios Aid Financial Management**

Even if a business has high profitability, it can face short-term financial problems if its funds are locked up in inventories and receivables not realizable for months. A business has to pay its suppliers, meet current expenses like staff salaries and marketing incidentals, and other immediate obligations on a continuing basis. Any failure to meet these can damage its reputation and creditworthiness and in extreme cases even lead to bankruptcy.

Liquidity ratios are the business ratios that can reveal the likelihood and causes of any such problems (Gopinathan Thachappilly, 2009).

### **2.13 What do Liquidity Ratios Measure?**

Liquidity ratios work with cash and near-cash assets (together called "current" assets) of a business on one side, and the immediate payment obligations (current liabilities) on the other side. The near-cash assets mainly include receivables from customers and inventories of finished goods and raw materials. The payment obligations include dues to suppliers, operating and financial expenses that must be paid shortly and maturing installments under long-term debt.

Liquidity ratios measure a business' ability to meet the payment obligations by comparing the cash and near-cash with the payment obligations. If the coverage of the latter by the former is insufficient, it indicates that the business might face difficulties in meeting its immediate financial obligations. This can, in turn, affect the company's business operations and profitability (Gopinathan Thachappilly, 2009).

The near-cash assets are not all equal in their nearness to cash. Inventories are farthest from cash (apart from advance payments and such minor items) as they typically become receivables when sold which have to wait a further period before becoming cash. Receivables can also be very far from cash if customers are given several months to pay their dues.

It is thus the speed of converting the different near-cash assets into cash that is important. The cash conversion cycle measures this speed, and is used along with liquidity ratios to assess a business' short-term financial prospects (Gopinathan Thachappilly, 2009).

## **2.14 Liquidity Ratio Computations**

- **Current Ratio = Current Assets / Current Liabilities:** Current ratio works with all the items that go into a business' working capital, and gives a quick look at its short-term financial position. Current assets include Cash, Cash equivalents, Marketable securities, Receivables and Inventories. Current liabilities include Payables, Notes payable, Accrued expenses and taxes, and Accrued installments of term debt).
- **Quick Ratio = Current Assets minus (Inventories + Prepaid expenses + Deferred income taxes + Other illiquid items) / Current Liabilities:** Quick ratio excludes the

illiquid items from current assets and gives a better view of the business' ability to meet its maturing liabilities.

- $\text{Cash Ratio} = (\text{Cash} + \text{Cash equivalents} + \text{Marketable Securities}) / \text{Current Liabilities}$ :  
Cash ratio excludes even receivables that can take a long time to be converted into cash. This ratio is typically less than one (1), because some cash can be expected to be generated from receivables and other sources. Holding too much cash is poor investment of funds because cash does not produce any returns. A business can be profitable and yet be unable to meet its immediate payment obligations if it has poor liquidity. Liquidity is measured quickly by dividing current assets by current liabilities giving the current ratio. Current ratio can be misleading if current assets consist a high proportion of illiquid items.

## **2.15 Corporate Governance and Financial Ratios**

Accounting information is important for rationalizing the decision of users of corporate reports in banks. Among the most important of the users groups are investors and creditors. Those users read the contents of the financial statements and calculate a variety of financial indicators before they make credit and investing decisions, because they believe that financial indicators have productive power.

Among the most widely used indicators are financial ratios. Financial ratios are used for a number of reasons, to value firms, to differentiate creditworthy companies from others, to identify acquisition targets and to indicate the process of organizational turnaround.



The usefulness of financial indicators depends on the integrity of the financial statements. The integrity of financial statements disclosure is directly related to the quality of a firm corporate governance practices. Agency conflict between controlling shareholders and minority investors are found to account for significant portion of earnings management in Ghana listed firms. Corporate governance practices are also found to impact credit ratings the cost of debt and firm value (Gompers et al 2003). Fitch 2004 asserts that shareholders and creditors interest are generally aligned when better monitoring of management occurs. Other attributes of corporate governance have a less clear impact on creditors.

Altman's (1968) model to predict company bankruptcy promotes a huge literature on the usefulness of financial ratios. Another perspective comes from studies that survey actual users of corporate reports. Some of this research finds that credit analysts and financial analysts attach particular importance to corporate reports. If this is the case, readers of corporate reports need to use analytical approaches to evaluate the financial information. One of the most approaches is financial ratios, European Journal of Economics, Finance and Administrative Science (2008)

## **2.16 Rural Banks**

Rural banks, offer loans and/or technical assistance in business development to low-income community in developing countries. Therefore rural banks should be an effective development agent and alleviate poverty (OECD, 1996). One of the central issues of development economics that governments and policy makers are focusing attention on is how to improve the socio-economic well being of the people and thereby, reduce deprivation and misery (Englama and Bamidele, 1997). In Ghana, rural banks have been established to play

a major role in providing financial management support, investment profiling and counselling to facilitate poverty alleviation in the rural districts or communities they serve. The banks major target groups are smallholder traders and farmers and they act as intermediary between the government and cocoa producers by purchasing government payment cheques from farmers. These components focus on strengthening the operational effectiveness of the rural banks that seed to promote women's banking initiatives, promote growth to reduce poverty and eliminate strict gender demarcation lines among bank customers in Ghana (Owusu-Frimpong, 2008).

The origins of rural banking dates back to 1976 when the Bank of Ghana (BOG) initiated a move to establish rural banks with the expressed purpose of providing both commercial and developmental banking activities to meet the needs of the rural areas.

Primary, the objectives of the rural banks are to:

- Extend and deepen rural financial intermediation to facilitate the payments system and promote savings and investment process;
- Bring banking services to the doorstep of the rural population to be able to monetise the rural economy and thereby, reduce the size of money outside the banking system;
- Provide necessary institutional credit to the rural dwellers to enable expansion of farming activities and other income generating commercial ventures that would help to improve their livelihood; and

- Act as instruments of economic development through provision of commercial loans to the local councils and town development committees that must support development of community projects like building of markets, schools and health centres. (Owusu-Ansah, 1999)

About sixty (60) per cent of Ghana's population of twenty five (25) million are rural dwellers whose livelihood is dependent on agriculture and often, are the worst affected by poverty. The financial sector structural adjustment Programme has largely contributed to the revival of the sector by strengthening the banks, improving the regulatory framework and restructuring financially distressed banks through the diffusion of new capital and management expertise. The rapid transformation of Ghana's banking industry has led to the strengthening of rural banking institutions by developing, organising and training communities to support capacity building in the rural areas. Presently the financial system in Ghana is dominated by the banking sector, in which all the banks are majoring in the retail banking business, dealing mostly in short-term money instruments. In addition to the high street banks, there are presently one hundred and fifteen (115) rural banks with five hundred (500) branch network (agencies) designed to serve farmers. The rural banks minimal market share of 5.6 per cent might be due to staffing problems that had led to low financial resource mobilisation, culminating in inadequate loanable funds (Owusu-Frimpong, 2008).

The rural banks offer both financial and non-financial service to the communities they serve. The financial services include lending, savings and other banking services such as cheque clearing for cocoa farmers. Non-financial services include supply of agricultural inputs to farmers. The rural banks grants loans that are payable within 4 -12 months, and accept flexible payments on weekly, biweekly and monthly bases. In some loan applications, the

banks often require the beneficiaries to be already involved in some economic activity and to deposit about twenty-five (25) per cent of the intended amount before the loan is approved. (Owusu-Frimpong, 2008)

### **2.17 Role of Rural Banking**

If current agricultural trends continue, by the year 2020 sub-Saharan Africa's food shortage will increase twenty times, to 250 million tonnes (Pinstrup-Anderson 1993). The lower calorie intake could lead to poverty, malnutrition and hunger. In an attempt to alleviate some of these potential problems, several institutional and non-institutional sources of rural credit have been made available to Africans. It is hoped that, in the long term, credit will enable the poor to invest in agricultural and non-agricultural productive assets, to adopt new technologies and farming methods and to minimize environmental degradation. Ghana, like other sub-Saharan countries, has traditionally experienced low productivity, low income levels, low domestic savings, unemployment, and malnutrition. In 1976, the Ghanaian government, through the Bank of Ghana, established Rural Banks to channel credit to productive rural ventures and promote rural development. Rural development is a strategy intended to improve the economic and social life of the rural poor (World Bank 1975). Rural credit has been used in Ghana to enable the poor to weather shocks without selling the productive assets the poor need for protection against future shocks (FAO 1994). According to the Moshi Conference (1969), the purpose of rural development is “a rise in the standard of living and favorable changes in the way of life of the people concerned.” However, there is some anecdotal evidence that many beneficiaries of Rural Bank credit are salaried workers, whose likelihood of loan repayment is believed to be better

than that of the small-scale rural producer. There is also some evidence that loan recipients use the credit for purposes other than those for which the loans are intended. Much analysis has not been done on the effectiveness or the impact of the Ghanaian Rural Banks on rural farmers.

## **2.18 Evaluating the Financial Performance of Rural Banks**

Aboagye and Otioku (2009), in their study measures financial performance based on the function that rural banks perform as banks. They claim, rural banks mobilize funds and make loans, which they expect to be repaid with interest and on time. To continue in business, rural banks must make enough money to cover their operational and financing costs, and retain earnings to finance future operations so that the rural banks can grow.

Thus, they discuss financial performance along several dimensions, namely

- Size of rural banks. As the real value of total assets increases over time the more business it is doing or in position to do.
- Deposits mobilization. Savings are a stable source of funds for financing loan portfolios and helping the economic growth of local communities and of the economy as whole. They compute the real value of deposits and deposits as proportions of total assets.
- Loan portfolio. Granting of loans is a major function of rural banks. But such loans must be paid back if the institutions are to continue to be in business. Thus, rural banks whose loan portfolio is of acceptable quality and growing must be doing

good business. They compute the real value of loans, loan portfolio as a proportion of total assets, and quality of the loan portfolio using the ratio of provision for loan losses and doubtful accounts to gross loans.

- Profitability. Rural banks are in business to make profits. All things being equal, higher profitability is preferred. They measure annual profit/average total asset (return on assets).
- Expenses. Rural banks are expected to encourage savings among their clientele. It would help if they paid high interest on savings. They compute the ratio of interest paid on savings to savings mobilized (interest expense ratio). A higher value of this ratio is preferred. Rural banks expenses may also be analyzed by focusing on its efficiency (control over cost). They investigated the ratio of rural banks non-interest expenses to the sum of net interest income and all other income (the operating expense ratio). For this ratio, the lower the better.
- Risk is uncertainty associated with the expected value of a variable. Given historical data, one computes the standard deviation of the historical means. Generally, lower volatility is preferred.

## **2.19 Profile of Asante Akyem Rural Bank Limited**

The establishment of Asante Akyem Rural Bank Limited (AARB) was a gracious response by the Government of Ghana to the appeal to help alleviate the suffering of Cocoa Farmers of Juansa and the surrounding villages at that time when they had to travel long distances of 36 kilometers virtually on foot to cash their Akuafo Cheques

at the Ghana Commercial Banks at Agogo and Konongo, the banks nearer them at that time.

Asante Akyem Rural bank was incorporated in Ghana in December 1980 and it was authorized to carry on the business of banking under the banking Act 1970 (Act 339) on 27<sup>th</sup> March 1981.

### **Business Mission of the Bank**

“The Asante Akyem Rural Bank’s mission is to be reliable rural financial Intermediary capable of mobilizing idle local funds to support viable economic venture in its operational area, as a way of promoting growth and improve standard of living of its client and the communities it serves”

### **Objectives**

The objectives of the bank are as set out below:

- ✓ Providing quality prompt and efficient rural banking service to its clients.
- ✓ Working profitably to ensure the payment of good returns on shareholders funds.
- ✓ Promoting the socio-economic development of its operational areas.
- ✓ Developing the banking culture of the people in its operational areas.
- ✓ Developing the banking skills of both staff and directors’ of the bank.
- ✓ Improving the quality of life of people in its catchment area.

## **2.20 Role of Asante Akyem Rural Bank Limited to its Catchment Area**

The Asante Akyem Rural Bank limited (AARB) has been immense contribution to the rural Folks in the catchment areas it is located.

Among the major contributions could be ascribed in the following areas:

1. Scholarship to brilliant and intelligent needy children of shareholders to further their education to the tertiary level.
2. Micro finance loan to petty traders in the environment in which the banks are located
3. Lend loans to the present farmers, who were turned down by the commercial banks.
4. Social responsibilities such as; providing street lights, building of markets and places of Convenience.



## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.0 Introduction**

This chapter discusses the methodology used for the study. The researchers need to provide a clear description of how data were collected. It explains sections as research design, population, sampling and sampling techniques/methods, data validity, data reliability and data analysis.

#### **3.1 Research Design**

The research design used for this study was descriptive study. This seeks to gather data so that a descriptive of what is going on can be made to discover whether there is any relationship between two variables. Descriptive study could be used to collect data through interview, observation or library research. The descriptive study was chosen because it enables easy description of the problem under study.

#### **3.2 Population and Sampling Technique**

This study focuses on the entire rural banks in Ghana as the population. A purposive sample was used to choose one of these rural banks, Asante Akyem Rural Bank. From Asante Akyem Rural Bank Limited fourteen staff including the accountant, one (1) manager, ten (10) operational staff and two (2) internal auditors were chosen purposely for the study.

The researchers used a combination of purposively sampling and random sampling technique to select elements.

The Accountant was purposively selected whilst the other thirteen staffs were selected at random from the administration, marketing, information technology and audit departments.

### **3.3 Primary Source of Data collection**

Interview is a face to face meeting between a questioner and a respondent. The interview was used for the study since the response rate is high and issues can be clarified.

### **3.4 Secondary Source of Data collection**

The financial statements of the Asante Akyem Rural Bank Limited between 2004 and 2010 were scrutinized for the study.

Further, the researchers sought and obtained relevant secondary data in the form of annual financial statements, reports and other vital publications.

These form the basis upon which empirical data was gathered to help answer the research questions. Interview and documents analyses were chosen as data collection techniques for good reason. The former affords respondents the advantage of flexibility and expression of one own opinion without undue interruptions whereas the latter gives credence to verifiability ease of reference and consistency.

### **3.5 Data Collection Procedure**

This sub-section of the methodology chapter spells out how data has been collected for this study. Once the sample for the study has been chosen, the researchers made contacts with the selected respondents for an initial briefing session. The initial briefing was meant to solicit the support and fraternize with the selected respondents in order to allay any potential fear that they might have harbored.

Potential difficulties and issues that needed clarification as far as the planned interview was concerned were discussed dispassionately and convincing conclusions reached.

A final briefing session was held at which dates for interview were agreed upon. A new interview schedule that had considered issues that arose at the initial briefing session was also drawn up.

### **3.6 Data Reliability**

Reliability refers to a measure's ability to yield consistent results each time it is applied. In other words, reliable measures do not fluctuate from time to time unless the thing being measured has changed.

To ensure that data collected via interview and document analyses are valid, the researchers constructed the interview schedule by avoiding ambiguous words and phrases in the sentences. Also, in the course of the interview, the researchers had to direct and redirect the respondent so that they answer the

questions specifically without diving into issues that have no bearing to the question posed.

### **3.7 Data Analysis**

Data analysis deals with establishing trends and binding relationships among data that had been collected from different sources.

In this study, data was analyzed by resort to tabular representation of data to ease comparing and to enable readers visually appreciate the finding from the study.

## CHAPTER FOUR

### PRESENTATION OF DATA AND DISCUSSIONS OF RESULTS

#### 4.0 Introduction

This chapter presents and discusses the analysis of the findings from the study. The findings are presented in tabular and graphical form.

In the tables, the findings on performances of Asante Akyem Rural Bank Limited have been expressed under the headings of the categories of ratios calculated. However, responses from interviews conducted on this exercise have also been included in the form of explanation. The categories of the ratios calculated are presented in the following tabular forms; profitability ratios, efficiency or activity ratios, liquidity ratios, leverage or gearing ratios and investors or shareholders ratios.

**4.1: Table 1. Computation of Profitability Ratios Results from 2004 to 2010**

Ratios	2004	2005	2006	2007	2008	2009	2010
ROCE	23%	20%	19%	32%	21%	15%	17%
Net profit margin	13%	10%	18%	24%	16%	17%	17%
Gross profit margin	48%	49%	92%	96%	95%	94%	93%
Net Asset	1.72	1.93	1.05	1.33	1.33	0.88 times	0.98

\turnover	times	times	times	times	times		times
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Source: Author Field Survey, 2011.

Table 1 indicates the performance under the first category of the financial ratios.

The returns on capital employed (ROCE) from 2004 to 2010 are as follows; 23%, 20%, 19%, 32%, 21%, 15% and 17% respectively. This shows that in 2007 they had the highest returns on capital employed (ROCE) by 32% and in 2009 it had 15% which shows the lowest return on capital employed.

In 2007, it is clear that the contributions or inputs from shareholders who are deemed to be the owner of Asante Akyem Rural Bank Limited were efficiently applied or used by management in generation of 32% as returns on their investment.

In 2010, Asante Akyem Rural Bank Limited recorded a second lowest percentage of 17. Though the lower performance of the bank had a bearing on weak management performance, when one looks around most farmers could not fulfill their loan obligations.

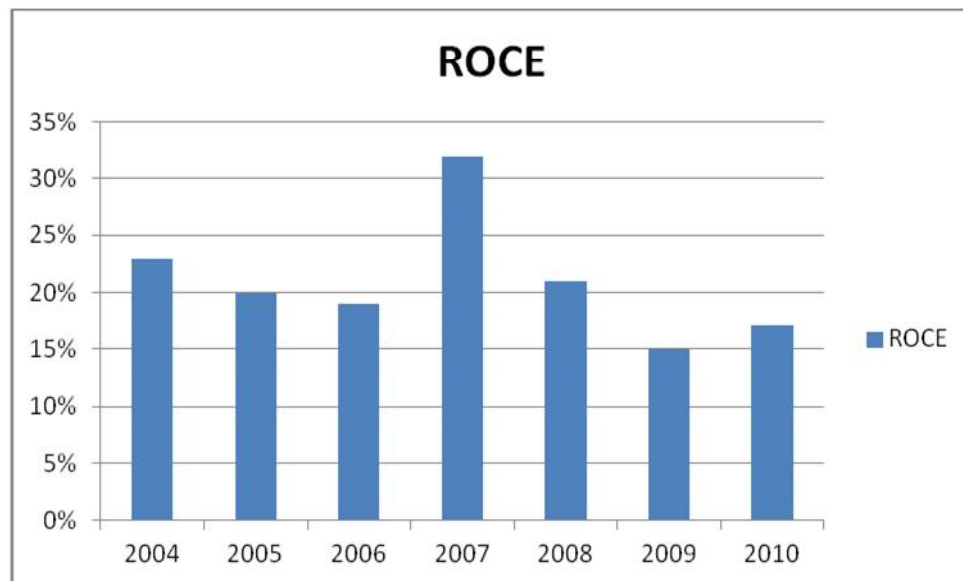
This was a result of weather failure. In Ghana most farmers depend on the usual seasonal rainfall.

In Addition to the above explanation, asset is seen as a crucial part in calculation of return on capital employed (ROCE), therefore there is a need to stress heavily on investment activities under taken by the Asante Akyem Rural Bank Limited during the number of years under reviewed.

The investment activities taken by the bank yielded a lower return. This was due to the fact that certain bills and bonds purchased by the bank had a lower benefit rate.

Example the rate of interest on Treasury bills was low.

Figure 1: ROCE from 2004 to 2010



Source: Author Field Survey, March 2012.

The bar graph above is a graphical representation of Return on Capital Employed (ROCE) of Asante Akyem Rural Bank Limited.

From the bar graph drawn, year 2007 shows the highest level of Return on Capital Employed, as well the year 2009 show the worst outlook on return on capital employed. The graphical representation adds and confirms to the explanation above.

The Net Profit Margin shows the efficiency with which costs have been controlled in the generation of profit from sales.

From 2004 to 2010 the net profit margins were as follows; 13%, 10%, 18%, 24%, 16%, 17% and 17% respectively. From this performance, Asante Akyem Rural Bank Limited was able to efficiently controlled cost in the generation of profit from sales by 24% in 2007 and in 2005 it was 10%.

In 2005, the bank shows a net profit margin of 10%, indicating a low margin of safety and a higher risk. A decline in customers' deposit, repayment of advances/ loans will erase profit and this will result in net loss. More so, high operating expenses and lower interest on customers' loans has a link to low net profit margin realized.

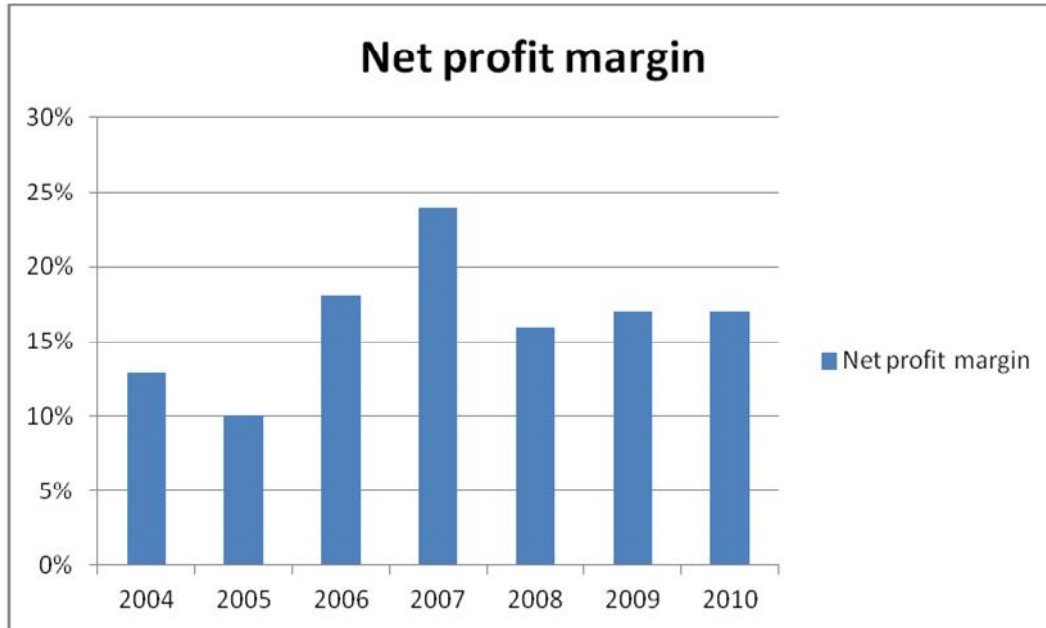
In comparing 2005 to 2007, there was an increase in the profit margin by 14%. This was an indication of the effectiveness proved by the bank in converting revenue into actual profit.

In 2007, certain expense which led to a lower net profit margin in 2005 was ceased by management.

In 2007, more prudent measures were introduce by the Bank's board of directors, leading to high effective cash management and therefore a reasonable net profit margin was feasible.



Figure 2: Net Profit Margin from 2004 to 2010.



Source: Author Field Survey, March, 2012.

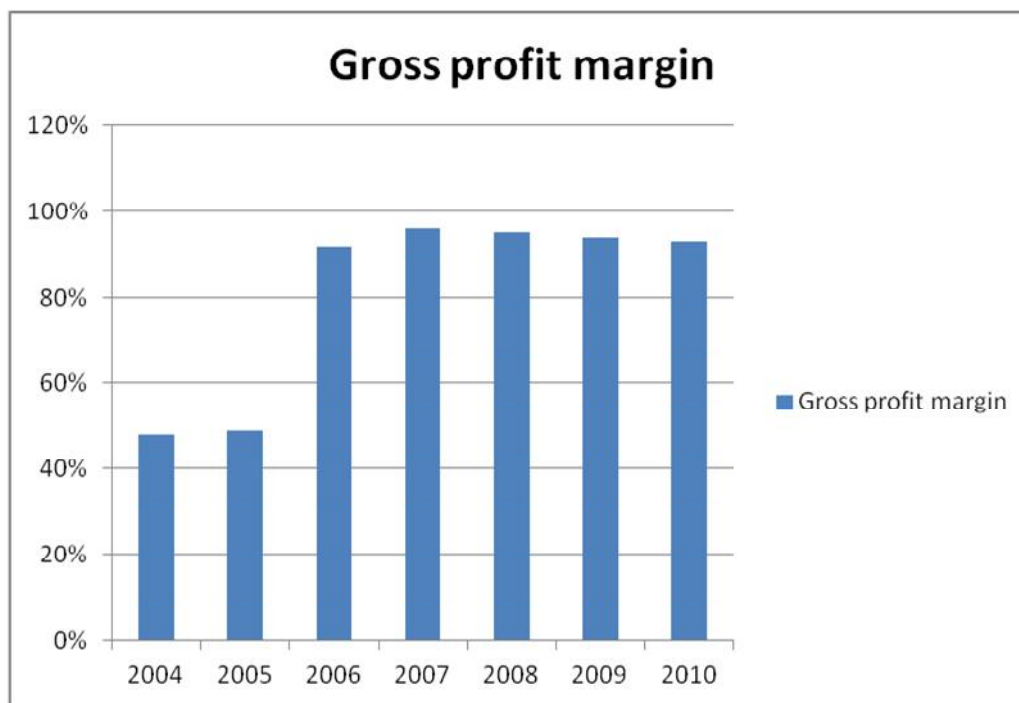
The bar graph above gives a graphical representation of the Net Profit Margin of Asante Akyem Rural Bank Limited. It adds and confirms to the explanations given above.

The Gross Profit Margin show how costs of providing services were controlled by Asante Akyem Rural Bank Limited. From 2004 to 2010 cost of rendering services had been controlled by the following percentages; 48, 49, 92, 96, 95, 94 and 93 respectively.

From this observation we can see that in 2007 cost of rendering services was controlled by 96% and in 2004 cost of rendering services were also controlled by 48%.

A higher gross profit margin recorded in 2007 tells us that, the bank was more liquid and thus has more cash flow to spend on its operations. Examples, research and development expenses. A lowest gross profit margin was of the worst side. In 2004, the bank recorded a percentage of 48. The lowest percentage of 48 shows that the bank could not keep its cost under control. The lowest gross profit margin explains a reduction in customers deposit and lower returns on investment.

Figure 3: Gross Profit Margin results from 2004 to 2010



Source: Author Field survey, March, 2011.

The bar graph above shows the representation of the gross profit margin of Asante Akyem Rural Bank Limited. It also adds and confirms to the explanations given above.

In an interview conducted with some employees of Asante Akyem Rural Bank Limited highlighted that most of their banking halls are rented. The rent paid for all these rented apartments are very high and this increases the expenditure. New agencies or branches were opened during 2008 to 2010, as a result of this the bank has to spend money to furnish the newly branches or agencies, train other new employees. All these were some of the reasons why in comparing the Net Profit margin with the Gross Profit Margin, there were vast differences from 2006 to 2010 net profit margin.

The Net Asset Turnover shows how well assets have been utilized in the generation of sales. From 2004 to 2010 the net asset turnover are as follows; 1.72, 1.93, 1.05, 1.33, 1.33, 0.88 and 0.98 all in times respectively.

This shows that in 2005 the bank was able to utilize its assets 1.93 times in the generation of sales which was the highest among the years chosen and in 2009 it had 0.88 times utilization of its assets in the generation of sales.

**4.2: Table 2: Computation of Activity Ratios results from 2004 to 2010**

Ratios	2004	2005	2006	2007	2008	2009	2010
Debtor Ratio	83 weeks	107 weeks	191 weeks	266 weeks	235 weeks	167 weeks	158 weeks
Fixed Asset Turnover	2.21 times	1.83 times	0.3 times	0.56 times	1.41 times	1.89 times	2.0 times

Source: Author Field Survey, March, 2012

The table above shows the performance of Asante Akyem Rural Bank Limited under the Activity Ratio category.

The debtors collection period or debtors ratio shows the following results from 2004 to 2010; 83, 107, 191, 266, 235, 167 and 158 all are in weeks respectively.

From the years calculated for the collections of money from debtors, the bank did not do well at all because; in 2004 the bank used 83 weeks in collecting money from its debtors which was least among the collection periods.

From this observation the bank had a poor debtor collection policy.

The Fixed Assets Turnover also shows the following results from 2004 to 2010; 2.21, 1.83, 0.3, 0.56, 1.41, 1.89 and 2.00 respectively.

These show the number of times that fixed assets have been utilized in the generation of sales.

In 2004, the Asante Akyem Rural Bank Limited was able to utilize its fixed assets 2.21 times in the generation of sales whereas in 2006 it was able to utilize its fixed assets by 0.3 times. From the observation of the bank's utilization of fixed assets in the generation of sales was 2.21 times in 2004 and declined to 2006, rose up a bit in 2007 by 0.26 and in 2008 to 2010 there had a steady increases in utilization of fixed assets in the generation of sales.

**4.3: Table 3: Computation of Liquidity Ratio results from 2004 to 2010.**

Ratios	2004	2005	2006	2007	2008	2009	2010
Current ratio	1.1 times	0.36 times	0.67 times	0.87 times	0.42 times	0.62 times	1.06 times

Source: Author Field Survey, March, 2012

The current ratio measures a company's ability to meet its financial obligations as and when they become due. From the computation of the current ratio the number of times that the Asante

Akyem Rural Bank Limited can meet its short term financial obligation as when they fall due from 2004 to 2010 are as follows; 1.1, 0.36, 0.67, 0.87, 0.42, 0.62 and 1.06 all in times respectively.

As compared to the normal current ratio which should be 2 times. So from the observation, only in 2004 is when the bank was able to meet its short term financial obligation as they become due by 1.1 times which was the highest from 2004 to 2010. Whiles the standard current ratio which is 2: 1 times.

We can say that the performance was not bad but, the standard current ratio as compared with the performance of the bank; the bank did not do well in term of meeting its financial obligation as and when they fall due.

**4.4: Table 4: Computation of Gearing Ratios results from 2004 to 2010.**

Ratios	2004	2005	2006	2007	2008	2009	2010
Interest cover	0.36 times	0.28 times	0.30 times	0.47 times	0.24 times	0.25 times	0.24 times
Debt/ Equity Ratio	102%	193%	106%	71%	143%	139%	75%

Source: Author Field Survey, March, 2012

The calculation of interest cover shows the following result from 2004 to 2010; 0.36, 0.28, 0.30, 0.47, 0.24, 0.25 and 0.24 respectively, all in times.

From the calculation of interest cover ratio, the Asante Akyem Rural Bank Limited is highly burdened by debt expense. This is because, the calculations show a lower interest coverage ratio and making its ability to meet its interest expenses very questionable.

Interest coverage below one (1) indicates that Asante Akyem Rural Bank Limited is not generating sufficient revenues to satisfy interest expenses.

From the calculations of Debt/ Equity Ratio, it shows the following results; 102%, 193%, 106%, 71%, 143%, 139% and 75% respectively.

The calculation of debt/equity ratio, in 2007 shows a lowest percentage of 71 as compared to the other years. This means that in 2007 the Asante Akyem Rural Bank Limited did not borrow a lot of funds, which means low risk.

One can attest to the fact that the Bank did depend on its internally generated funds. (Example customers' deposit, bank charges and other returns from the bank's investments). More over, the demands for assessing loans by customers were on the highest side.

In 2005, the bank recorded the highest debt/ equity ratio among the calculated years, which show a percentage of 193. In 2005 there was a heavy dependence by the bank on borrowed funds which means more risk ahead of the bank in subsequent years.

In this case, the bank is obliged and will need to perform and have sufficient operating profit from the first year itself. In order to meet the interest cost and repay the year loan installment. If all attempts to repay the first year's loan installment fails, the bank can struck a deal to start repayment of the loan after a couple of years. This will help the bank to have enough time periods for growth and mobilization of fund for loan repayment.

**4.5: Table 5: Computation of Investors/ Shareholders Ratios Results from 2004 to 2010**

Ratios	2004	2005	2006	2007	2008	2009	2010
Returns on Equity	21%	18%	17%	29%	186%	20%	20%

Source: Author Field Survey, March, 2012

The return on equity measures the amount of net income earned by utilizing each cedi of total common equity. By this we can find out how much the shareholders of Asante Akyem Rural Bank Limited are going to get for their shares.

The highest return on equity for 2008 addresses how efficient management was, in utilizing its equity base. The return on equity was high in 2008.

In 2005, the return on equity was low by a percentage of 18; this was due to long term debt paid off.

The study also took into consideration whether the Asante Akyem Rural Bank Limited rightly apply the accounting ratios in the in financial statement analysis

**4.6: Table 6: Summary of the respondents on how the bank applies Accounting Ratios.**

Responses	Number	Percentage
Yes	3	21%
No	4	29%
Don't know	7	50%
Total	14	100%

Source: Author Field Survey, March, 2012

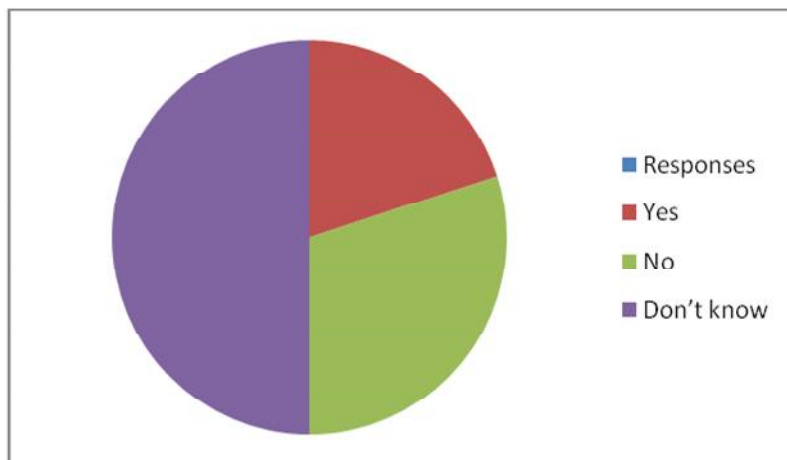


It can be observed from the table 6 that, three (3) of the respondents representing 21% said that the bank rightly applies accounting ratios, four (4) respondents representing 29% said the bank did not Correctly apply accounting ratios, while seven (7) respondent representing 50% said they did not know whether the bank correctly apply accounting ratio.

It stands to reason that the employees of Asante Akyem Rural Bank Limited lack information pertaining to the operations of the firm and this trend has the tendency of stifling interest in the employees in knowing the directions in which the company is heading.

The financial statements and reports should be made available to the staff who have at least served the bank for three years and more to know the financial performance of the institution.

Figure 4 shows respondents on the application of Accounting Ratios



Source: Authors Field survey, March, 2011.

The pie chart also gives clear interpretations on how the employees of the bank apply Accounting ratios. The red colour represent those who said yes, green colour represent those said the no and the violet colour represent those who do not know whether the bank apply

accounting ratio. This really shows that half of the employees representing almost all the employees do not know where the bank is heading to. This confirms to what is written above.

## **CHAPTER FIVE**

### **SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.0 Introduction**

This chapter covers the summary of the findings, the conclusions and recommendations that were made by the researchers.

#### **5.1 Summary of Findings**

1. It was found out that there was no consistency in the performance of the bank under the profitability ratio. Table 1 shows, for example the return on capital employed for 2004 which was 23% decreased to 20% in 2005, decreased in 2006 and increased to 32% in 2007 and it decreased to 17% in 2010. This shows inconsistency in the profitability level of the bank. This was a result of weather failure and lower interest rate on bills and bonds purchased by the bank.
2. The study showed from the table 2 that, for the performance of the bank under the activity ratios, revealed a poor debtor collection policy.
3. The study also showed or brought to light based on how and when the bank meets its short term financial obligation when they fall due. The study showed that as the performance under current ratio, the bank was not liquid when compared with the standard current ratio.

4. Addition to this, the study also showed from the calculation of interest cover ratio, the Asante Akyem Rural Bank Limited is highly burdened by debt expense. This is because, the calculations shows a lower interest coverage ratio and making its ability to meet its interest very questionable. Interest coverage below one (1) indicates that Asante Akyem Rural Bank Limited is not generating sufficient revenue to satisfy interest expenses.
5. More so, the study brought to light based on the calculation for returns on equity under the investors/ shareholders ratio. It showed for every cedi invested by the shareholders yield profit, with this ratio is of great importance to the present and prospective shareholders as well as management of the bank.
6. The last but not the least, from the table 6, the study showed that some of the employees of Asante Akyem Rural Bank Limited lack information pertaining to the operations of the firm and this trend has the tendency to stifle interest in the employees in knowing the directions in which the company is heading.

## **5.2 RECOMMENDATIONS**

From the findings and conclusions, it can be recommended that, much effort should be put in by management towards its performance to continue to have either constant or increase in their performance under the profitability ratio, especially for return on capital employed (ROCE)

Secondly, there should be a specific number of days set in which debtors should settle their debt. Some other measures should be put in place to make sure that the debtors are committed to their obligations in settling of their debts. This should be done under the activity ratio for debtor collection period. This will help the bank have a good debtors collection period policy.

Third, the liquidity ratio showed that the bank was not able to pay its short term financial obligation. The researcher recommends that, when those measures stated in the second point is apply properly, the bank will be able to get enough funds to finance their short term financial obligation as and when they fall due.

Fourth, the interest cover ratio under the gearing ratio shows that the bank is not generating sufficient revenue to satisfy interest expenses. The bank should therefore put its funds in investments that will yield good returns.

More so, the returns on equity under the shareholders or investors ratios showed that, there was a return for every cedi that the investors or shareholders put in the business. From the management performance, it was good and when much effort is put in they can get better returns.

The last but not the least, the bank should make some of its financial statements and other

reports to the employees so that the employees will know where the bank is heading to.

### **5.3 Conclusions**

On the basis of the findings of the study it can be concluded that financial ratios can help institutions to determine their financial strength.

It can also help present shareholders and prospective shareholders or investors to make sound decisions to hold shares, buy additional shares or to sell the shares.

Addition to this, it also shows how the management are performing base on the shareholders or investors inputs.

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## APPENDIX I

### COMPUTATION OF THE CATEGORIES OF RATIOS

#### PROFITABILITY RATIOS COMPUTATION

#### RETURN ON CAPITAL EMPLOYED (ROCE)

$$\text{ROCE} = \frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100$$

Capital employed

NB: Capital employed = Total asset less current liabilities

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Net profit before interest and tax	993218	984660	107813	251039	188886	253422	313402
Capital employed	4455808	5079039	590687	802730	891729.91	1731892.61	1931982.7
ROCE	23%	20%	19%	32%	21%	15%	17%

## COMPUTATION OF NET PROFIT MARGIN

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

Sales

NB: Computation of Sales figure from the bank's financial statement

$$\text{Investment income} + \text{commissions} + \text{other operating income} = \text{Sale.}$$

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Net Profit	99321.80	98466.0	107813	251039	188887	253422	313402.47
Sales	764748.00	979336.4	617294	1065951	1181740	1524517	1889073
Net Profit Margin	13%	10%	18%	24%	16%	17%	17%

## COMPUTATION OF GROSS PROFIT MARGIN

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

Sales

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Gross Profit	365415.60	475969.7	50871	1020104	1123364	1429102	1746421
Sales	764748.00	979336.4	617294	106294	1181740	1524517	1889073
Gross Profit Margin	48%	49%	92%	96%	95%	94%	93%

#### COMPUTATION OF NET ASSET TURNOVER

$$\text{Net Asset Turnover} = \frac{\text{Sales}}{\text{Capital Employed}}$$

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Sales	764748	979336.4	617294	1065951	1181740	1524517	1889073
Capital Employed	4455808.	507903.9	590687	802736	891729.91	1731892.6	1931982.7
Net Asset turnover	1.72 Times	1.93 Times	1.05 Times	1.33 Times	1.33 Times	0.88 Times	0.98 Times

#### COMPUTATION OF ACTIVITY RATIOS

$$\text{Debtors collection period} = \frac{\text{Debtor}}{\text{Credit Sales}} \times 52 \text{ weeks}$$

Credit Sales

NB: We took credit sales as Interest Income from the financial statements.

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Debtors	489992.00	810034.50	1476442	2982572	3944789	3642514	4368740.96
Credit Sales	308591.90	394776.70	402428	584074	871273	1135171	1441876
Debtors collection Period	83 weeks	107 Weeks	191 weeks	266 weeks	235 weeks	167 weeks	158 weeks

#### COMPUTATION OF FIXED ASSET TURNOVER

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

Fixed Asset

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Sales	764748.00	979336.40	617294	1065951	1181740	1524517	1889073
Fixed Asset	347296.10	536764.50	2057647	1903485	838113	806696	943604
Fixed Asset Turnover	2.21 Times	1.83 Times	0.3 Times	0.56 Times	1.41 Times	1.89 times	2.Times

## COMPUTATION OF LIQUIDITY RATIOS

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

Current Liabilities

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Current Assets	1747004.9	1792940.2	2015735	1934297	1886541	6944544	9736620
Current Liabilities	2011608.3	2330517.9	3237393	4546008	5222361	6287628	9226532
Current Ratio	1.1 times	0.36 times	0.67 times	0.87 times	0.42 times	0.62 times	1.06 times

## COMPUTATION OF GEARING RATIOS

Capital Gearing Ratio =  $\frac{\text{Long Term Capital}}{\text{Capital Employed}}$

Capital Employed

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Long Term	106576.5	236272.5	21901.7	217917	540288	581095	514918

Debt							
Capital Employed	445580.8	507903.9	891730.9	802738	891730	1731892.61	1931982.7
Capital Gearing Ratio	23%	36%	24%	27%	60%	34%	27%

#### COMPUTATION OF INTEREST COVER

Interest Cover = Earnings before Interest and Tax

Interest Charges

NB: Interest charges = Total interest income less interest expenses.

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Earnings before interest and tax	99321.8	98466.00	107813	251039	188886.51	253422.42	313402
Interest charges	272772.0	354317.2	356005	538227	812897	1039856	1299224
Interest	0.36	0.28	0.30 times	0.47	0.24 times	0.25 times	0.24

Cover	times	times		times			times
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#### COMPUTATION OF DEBIT/EQUITY RATIO

Debt/ equity Ratio =  $\frac{\text{Long Term Debt}}{\text{Share Capital and Reserve}}$

Share Capital and Reserve

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Long term Debt	106576.50	236272.5	319017	217917	540288.64	581095	514918
Share Capital Reserve	103806	122048.70	205947	303498	375591.61	417678.20	683029
Debt Equity Ratio	102%	193%	106%	71%	143%	139%	75%

## COMPUTATION OF INVESTORS OR SHAREHOLDERS RATIOS

Returns on Equity =  $\frac{\text{Earnings after tax and preference dividends}}{\text{Shareholders Funds}}$

Shareholders Funds

NB: All the figures are in GH¢'000

Years	2004	2005	2006	2007	2008	2009	2010
Earnings after tax and pref. dividend	91555.8	91429.8	98557	227487	165553.9 1	226745.70	284578.09
Shareholders Funds	445580.8	507903.9	590687	802737	89172.91	1150797.61	1417064.7
Returns on Equity	0.21 times	0.18 times	0.17 times	0.28 times	1.86 times	0.20 times	0.2 times



## **APPENDIX II**

### **CHRISTIAN SERVICE UNIVERSITY COLLEGE**

#### **DEPARTMENT OF ACCOUNTANCY**

These questions for interview are being used to collect information on the ‘Usage of Accounting Ratios for assessing performance of Asante Akyem Rural Bank limited’. You will be contributing greatly to this study if could objectively respond correctly to these questions.

Please, the responses will be treated confidentially, because the study is for academic purpose only.

#### **Interviews Schedule**

1. How many years have you worked with Asante Akyem Rural Bank Limited?
2. Has the bank being using Accounting Ratios?
3. How long have you being making use of Accounting Ratios?
4. What information on Accounting Ratios does management require from Accountant for decision making purpose?
5. How often does the management require such information?
6. To what extent does the information on accounting ratios provided for specify decisions?
7. How often does the management use the accounting ratios to assess performance with the past years?

8. Do the Accountants have adequate logistic support to perform their routine duties?
9. Are the Accounting Staff of your organization well-equipped with the expertise to handle the challenges that come with their task?
10. Is the accounting system of your organization helpful in achieving the financial objectives of the bank?



**USING FINANCIAL RATIOS TO ASSESS THE PERFORMANCE OF BANKS: A  
CASE STUDY OF ASANTE AKYIM RURAL BANK LIMITED**

**AKUA TIMAH APPIAGYEI**

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**IVY TUFFOUR**

**ERNEST ASARE**

**A DISSERTATION SUBMITTED TO THE DEPARTMENT OF BUSINESS  
STUDIES, CHRISTIAN SERVICE UNIVERSITY COLLEGE IN PARTIAL  
FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE  
OF BACHELOR OF BUSINESS ADMINISTRATION**

**JUNE, 2012**



## **ABSTRACT**

This study attempts to look at the usage of financial ratios to assess the performance of Asante Akyem Rural Bank Limited.

The objectives of this study are therefore to help investors and other stakeholders to make sound investment decisions by continuing investing in the Bank.

The method employed involved the conducting of interviews with management and some key employees. The financial statements were used to compute the categories of ratios, analyzed and presented.

Among the key findings the study revealed it includes the following;

- 1 Inconsistency in the performance of the bank under the profitability ratios, especially for the return on capital employed.
2. It also showed that the bank had a poor debtor collection period under the activity ratios.
3. The study brought to light that the bank was not liquid when compared the current ratio performance to the standard current ratio.
4. From the calculation of interest cover ratio, the study showed that the Asante Akyem Rural Bank Limited was highly burden by debt expenses.
5. From the calculation of returns on equity ratio under the investor/ shareholder ratios showed that, for every cedi invested by the shareholders or the investors there is profit yielded on it.
6. The last but not the least from the interviews conducted, it brought to light that employees of the bank lack information pertaining to the operation of the bank.

## **DEDICATION**

We dedicate this work to our parents and all our love ones and friends for their profound support, love and encouragement for us which have made our dreams to the tertiary level a reality.

## **ACKNOWLEDGEMENT**

Our sincere appreciation and praise go to the God Almighty for His divine inspiration, strength, and grace given to us to obtain a degree.

We are thankful to our supervisor, Mr. Stephen Alewaba who despite his tight schedule, had time to guide us. We really appreciate his guidance, constructive critique and patience he has exhibited which enhanced this study significantly. Our prayer is that God should replenish all that he might have lost in his effort to give us the necessary assistance.

Our warmest thanks also go to all the staff of Asante Akyem Rural Bank Limited, especially Mr. Samuel K. Menka and Mr. Mohammed Ibrahim Anyars for the provision of the necessary information to carry on this study.

We appreciate all the friends who supported us with all kind of encouragement, prayers and help in diverse ways.



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