

## **Chapter No. 6**

### **Identifying areas of concern**

#### **6.1 Introduction**

Financial statements of a firm can be analysed to extract information that can facilitate decision making. Analysis of the financial statements can reveal whether the firm will be able to meet its long-term debt commitment, whether the firm is financially distressed, whether the company is using its physical assets efficiently, whether the firm has an optimal financing mix, whether the firm is generating adequate return for its shareholders, whether the firm can sustain its competitive advantage etc; While the information used is historical in nature, the intent is clearly to arrive at recommendations and forecasts for the future rather than provide a “picture of the past”.

One of the most popular way to analyse financial statements is by computing different types of ratios. Ratios are more of a diagnostic tool that help us to identify problem areas and opportunities within a company. Apart from ratio analysis, trend analysis can also be used as a tool to identify underlying or emerging trends in behavior of certain key financial parameters or ratios which may indicate improvement or deterioration in the performance in future. Critical examination of financial statements and annual reports containing management discussions & analysis report also provides lots of information about past financial performance of a firm, future directions, areas of focus, problems to be tackled and so on.

#### **6.2 Identifying areas of concern for BSNL**

##### **6.2.1 Identifying areas of concern through financial statements and annual reports**

A close and critical examination of information contained in Table No. 5.1 to 5.3 in Chapter No. 5 (prepared on the basis of financial statements placed at Annexure-A to Annexure-T and annual reports available at [www.bsnl.co.in](http://www.bsnl.co.in) containing management discussions & analysis report) reveals following areas of concern for BSNL:

- (i) One of the major area of concern for BSNL is operating revenue which it earns by selling services to customers. From the profit and loss statements pertaining to years under study, it is evident that the operating revenue of BSNL has been continuously declining from year 2005-06 until year 2011-12. From 2012-13 onwards, the de-growth in operating revenue has been arrested and it is showing an increasing trend though a weak one. The main factors which can be said to have attributed to fall in revenue are:
  - (a) Ever decreasing tariffs for voice services due to intense competition in the sector
  - (b) Shrink in the market share in different segments of telecom services due to liberalisation and open competition in every segment
  - (c) Continual decrease in the landline connections and fall in associated revenue for landline business which had been bread and butter for BSNL in the past.
  - (d) Lack of customer centric approach as an organization
  - (e) Abolition of access deficit regime
  - (f) Inadequate marketing skills and lack of customer friendly attitude of the legacy employees
- (ii) Another major area of concern for BSNL as evident again from profit and loss statements is expenditure towards employee benefits. Employee benefit expenses have been rising steadily from 20% of operating revenue in year 2005-06 to 54% of

operating revenue in year 2014-15. In quantitative terms, this expense has doubled in the last 10 years denting the profitability of BSNL to a large extent.

- (iii) The net profit has been declining at a very fast pace since year 2005-06 until year 2008-09. From year 2009-10, BSNL is in red and losses are mounting year after year. It had been making losses to the tune of Rs. 7000-8000 Crores during last four years.
- (iv) Provision for doubtful receivables have been of the order of Rs. 3700-4500 Crores during last 10 years and such higher provision on this front is also a matter of concern.
- (v) From the examination of segmental revenue as reported in annual reports, it is observed that revenue from Basic/other than cellular (including broadband) segment has been declining continuously from Rs. 32355 Crores in year 2005-06 to Rs. 15738 Crores in year 2014-15. Similarly, profit from this segment has also declined from Rs. 3965 Crores in year 2005-06 to a staggering loss of Rs. 10543 Crores in year 2014-15 though this segment had been the bread and butter for BSNL for so many years. Poor performance in this segment is another area of concern for BSNL.

#### **6.2.2. Identifying areas of concern through financial ratios**

As already explained in Chapter no. 4, the financial ratios can be used as a tool to pin point areas of concern in the financial performance of a firm. There are variety of ratios which can be calculated depending upon the requirement of the study. Accordingly, following ratios, as indicated in the Table No: 6.1 are being computed from financial statements placed at Annexure- A to Annexure- T.

**Table No. 6.1: Financial ratios for BSNL**

Sl. No	Financial Ratio/ Year	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
1.	Current ratio	2.79	3.22	3.34	2.79	1.29	1.20	1.18	0.85	1.06	0.75
2.	Liquidity ratio	2.62	3.08	3.15	2.57	1.17	1.02	0.99	0.66	0.89	0.59
3.	Net profit ratio	22.25	19.65	7.91	1.61	- 5.69	- 21.5	- 31.7	- 29.1	- 25.1	- 28.7
5.	Return on investment	11.07	8.98	3.41	0.65	- 2.11	- 7.97	-12.4	- 12.4	- 12.2	- 17.2
6.	Debt equity ratio	0.31	0.27	0.25	0.28	0.51	0.30	0.43	0.50	0.55	0.55
7.	Fixed assets to net worth	0.79	0.70	0.65	0.67	0.92	0.96	1.00	1.01	0.95	0.95
8.	Fixed assets turnover ratio	0.63	0.66	0.66	0.60	0.40	0.39	0.39	0.42	0.51	0.61
9.	Debtors turnover ratio	6.38	6.37	6.96	7.59	6.75	4.69	7.05	9.19	10.13	12.31
10.	Inventory turnover ratio	14.37	16.35	11.81	7.83	6.33	7.51	7.76	7.19	7.89	7.74

(Source: computed on the basis of information available in financial statements of BSNL for the study period)

Note 1: Debtors turnover ratio has been calculated by taking total income into account as information related to annual credit sales is not available in the financial statements.

Note 2: Inventory turnover ratio has been calculated by taking total income into account as information related to cost of goods sold is not available in the financial statements (BSNL is service centric company)

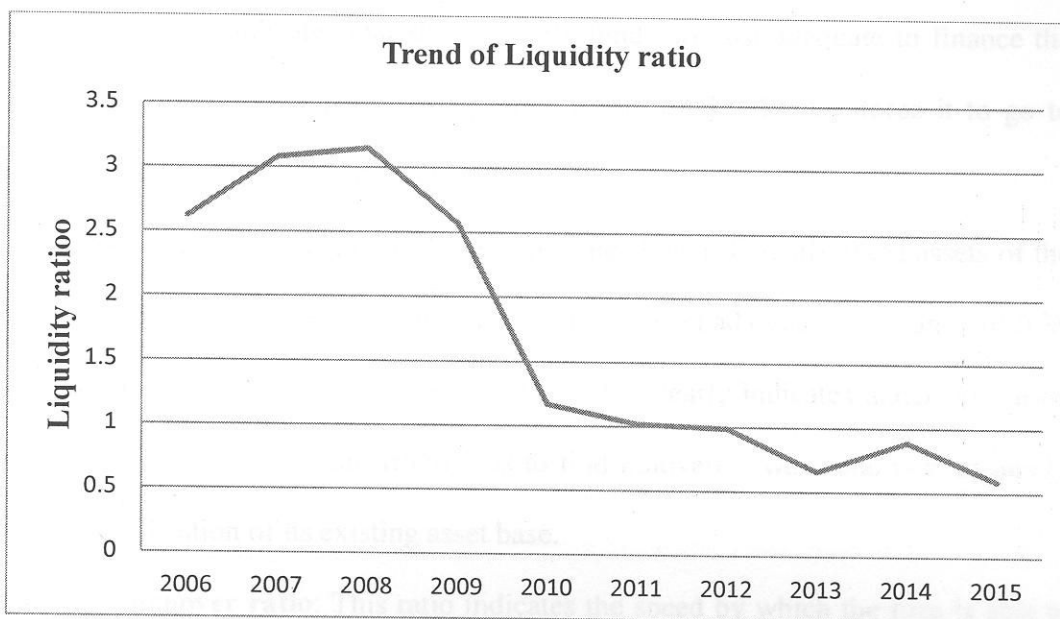
The analysis of above financial ratios is as under:

- (a) **Current ratio:** It is a measure of general liquidity and indicates short term financial position or liquidity of a firm. In case of BSNL, this ratio has been declining gradually from 1.29 in 2009-10 to 0.75 in year 2014-15 which indicates deteriorating liquidity condition. A current ratio of less than 1.0 should be a matter

of concern for the management as payment crisis may be developing in immediate future.

- (b) **Liquidity ratio:** It is also known as quick ratio or acid test ratio and is a measure of the ability of the firm to pay its short term obligations as and when they become due. In case of BSNL, this ratio too declined from 1.17 in year 2009-10 to 0.59 in year 2014-15. A declining trend in liquidity ratio indicates that BSNL may find itself in difficult situation as far as meeting short term liquidity obligations are concerned. The trend of liquidity ratio of BSNL over last 10 years as shown below clearly indicates the deteriorating short term liquidity position of the company.

**Figure No. 6.1: Trend analysis of liquidity ratio over last 10 years**



- (c) **Net profit ratio:** BSNL has been making huge losses since 2009-10 and recovery on this front does not seem to be nearby until and unless BSNL is successful in enhancing revenues and reducing expenses.

- (d) **Return on investments:** This ratio is declining continuously during the period of study and is a reflection of trend in net profit.
- (e) **Debt to equity ratio:** This ratio indicates long term solvency position of the firm. For a capital intensive sector like telecom, a ratio of 1:1 may be considered satisfactory. As for as BSNL is concerned, this ratio is less than 1 during the study period. Such a low ratio provides BSNL a sufficient cushion for raising long term debt for financing its network expansion programme in future.
- (f) **Fixed assets to net worth ratio:** This ratio indicates extent to which shareholder's funds are utilised in the creation of fixed assets. This ratio has been hovering less than 1.0 for most of the years during study period but during last 4-5 years, it is about 1.0 which indicates that shareholder's funds are just adequate to finance the fixed assets and continuous poor financial health of BSNL may force it to go to outsiders to finance the fixed assets in future.
- (g) **Fixed assets turnover ratio:** This ratio indicates how efficiently fixed assets of the firm are being utilised to generate revenue. This ratio had been in the range of 0.39 to 0.66 during the study period. Such a low ratio clearly indicates under utilisation of fixed assets in BSNL and BSNL has to find innovative ways and new means to increase utilisation of its existing asset base.
- (h) **Debtors turnover ratio:** This ratio indicates the speed by which the firm is able to collect its debt or receivables. BSNL seems to be doing reasonably well on this front as this ratio is showing an increasing trend during last five years of the study period.
- (i) **Inventory turnover ratio:** This ratio indicates how fast a firm is converting its inventory into finished products or services as the case may be. For BSNL, this ratio

was in the range of 11-16 during 2006 to 2008 largely due to high revenue. From 2009 onwards, it is hovering in the range of 6-8. Though A high inventory turnover ratio is desirable but in case of BSNL, the inventory turnover ratio seems to be reasonable keeping in mind that inventory items, generally, telecom equipments, are to be installed and commissioned before they can be utilised for providing services.

### **6.3 Summary of identified areas of concern**

Based on above analysis, the identified areas of concern in the financial performance of BSNL are summarised as under:

- (a) Substantial decrease in Operating revenue**
- (b) High expenditure on employee's benefits**
- (c) Heavy losses during last six years**
- (d) Higher provision for doubtful receivables**
- (e) Declining revenue and heavy losses on account of basic segment of services**
- (f) Delicate liquidity situation**
- (g) Under utilisation of fixed assets**

As per the objectives of the study, the managerial, operational and strategic factors which might also have contributed to deteriorating financial condition of the BSNL have not been taken into consideration while identifying areas of the concern as these are not visible in the financial statements or annual reports.