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**Investment Decision Analysis**

Table of Contents

[INTRODUCTION 3](#_Toc497684745)

[RATIO ANALYSIS 3](#_Toc497684746)

[PROFITABILITY PERFORMANCE 4](#_Toc497684747)

[Gross profit ratio 4](#_Toc497684748)

[Net Profit ratio 5](#_Toc497684749)

[LIQUIDITY RATIO 5](#_Toc497684750)

[Current Ratio 5](#_Toc497684751)

[Quick Ratio 5](#_Toc497684752)

[RETURN PERFORMANCE 6](#_Toc497684753)

[Return on capital employed 6](#_Toc497684754)

[EFFICIENCY ANALYSIS 6](#_Toc497684755)

[Account Receivable Collection Period 6](#_Toc497684756)

[INVESTMENT APPRAISAL METHOD 6](#_Toc497684757)

[Payback period method 6](#_Toc497684758)

[Internal Rate of return 7](#_Toc497684759)

[Net present value 7](#_Toc497684760)

[FACTOR ANALYSIS 8](#_Toc497684761)

[CONCLUSION 9](#_Toc497684762)

[REFERENCES 10](#_Toc497684763)

# INTRODUCTION

Financial analysis is an important part by which a company is able to analysis its financial position position and presents value in the competitive market (Aragonés-Beltrán, Pastor-Ferrando and Pla-Rubio, 2014). It is a best tool by which two or more companies will analysis its actual position by keeping the records of each and every transaction. This report presents the ratio analysis of two companies such as Forth and Clyde. It also described the various rules and formulas which is useful to make a complete evaluation of performance of a company. Furthermore, it also describes the investment decision by taking a view of company’s performance. It also explains the profitability capacity and earning power of both the companies. At last, investment decision taken by the companies also presents in the report.

# RATIO ANALYSIS

Ratio analysis is an important part of making a financial judgement of a company. It includes a complete understating of each and every activity which is performed by the companies (Aragonés-Beltrán, Pastor-Ferrando and Pla-Rubio, 2014). It includes various approaches to calculate the ratio and make a fair judgement for a business. It includes net profit and gross profit ratio by which company’s actual net or gross turnover can be an analysed effectively. By using this measurement tool, liquidity and asset turnover also measured by the financials of a company. It is a useful technique by which return of a performance also analysed and estimated b y the manager. This is useful because by analysing the actual performance of a company, it provide a complete overview of a business which is highly effective in nature. Furthermore, it also defined that to analysis the ratio and financial trends of a company, manager has to adopt specific skills and knowledge so that they will make better estimation of a company.

In the present case study, it presents the ratio analysios of two companies such as Forth and Clyde. By analysing the various ratios, manager will be able to keep complete records of each and every transaction of a company. The ratio analysis of two companies is as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Formula** | **Forth** | **Clyde** |
| Current ratio | Current assets / Current liabilities | 3.88 | 1.93 |
| Quick ratio | (Current assets-inventory) / Current liabilities | 1.95 | 0.76 |
| Receivables collection period | Accounts receivable / credit sale\*365 | 45.25 | 57.77 |
| Return on capital employed | Operating profit / Capital employed | 21.01% | 4.94% |
| Gross profit percentage | Gross profit / Sale revenue\*100 | 38.02% | 23.74% |
| Net profit percentage | Net profit / Sale revenue\*100 | 19.34% | 4.03% |

# PROFITABILITY PERFORMANCE

To analysis the company’s profitability and earning capacity, analysis of ratio plays an important role. It is an indicator by which manger is able to make right justification and evaluation of performance and its impact on the profit capacity of a business. It includes two ratio such as gross profit ratio and net profit ration to analysis the profitability and actual performance done b y the Forth and Clyde companies. These are as follows:

## Gross profit ratio

Gross profit ratio is a tool by which profitability and performance of a company can be evaluated effectively. It provides an actual earning power and capability of company. Hence, it can be said that gross profit ratio is the best profit analysis deducted which is highly related to the future estimation (Aragonés-Beltrán, Pastor-Ferrando and Pla-Rubio, 2014). It is useful ratio by which manager of a company analysis the funding capacity of firm in their operation activity. Thus, it can be said that it include actual or gross earning of a firm which is highly related to the future. From the above table and calefaction, it makes a comparison between two companies which is Forth and Clyde. By analysis the various transactions made by the companies, it can be said that gross profit of Forth is 38.02%. On the other hand, Clyde acquires the gross profit with 23.74%. By analysing this ratio, it can be said that gross margin of Forth Company is higher than Clyde. It shows that Forth Company has a good earning capacity as compare to Clyde.

## Net Profit ratio

Net profit ratio describes the net annual turnover of a company. It can be analysed by using the financial statement such as balance sheet and income statement of both two companies such as Forth and Clyde. From the above table the net profit ratio of Forth Company is 19.34%. On the other hand, net margin of Clyde Company is 4.03% which is very low as compare to the Forth Company. Hence, it can be said that Forth Company is in good position and tries various efforts to make it grow faster level.

# LIQUIDITY RATIO

## Current Ratio

It is the form of liquidity ratio which can be calculated by adding all the current asset and liability. After adding the current assets and liability, it will be divided with each other to get the current ratio of a company. It is also refers that the standard current ratio is 2:1. Here, the table presents the condition of both the companies. By analysing this, it can be concluded that the current ratio of Forth Company is 3.88. On the other hand, the current ratio of Clyde Company is 1.99. The standard ratio of the current ratio is 2 that indicate the business has rational liquidity location to gather the entire little phrase financial obligation with the in progress material goods. The liquidity spot of the concern will not facilitate to increase the commerce performance in the close to outlook. Consequently, the present relation reflects that there have to be assortment of Forth for the reason of benefit on the groundwork of liquidity place.

## Quick Ratio

Quick ratio shows the liquidity position of a company. It includes all the liquid items such a creditors, liabilities etc. which presents the liquidity and flexibility of the activity in a business. From the above table it presents that the liquidity ratio of Forth Company is 1.95, whereas, Clyde Company’s quick ratio is 0.76. It also described that the standard quick ratio is 1:1, which means that Clyde’s liquidity position is not good as compare top the Forth Company. Therefore, the quick ratio reflects that there should be selection of Forth for the purpose of investment on the basis of liquidity position.

# RETURN PERFORMANCE

## Return on capital employed

Return on capital employed refers the actual estimation of total invested funds which is related to the business activity (Agrawal, Catalini and Goldfarb, 2015). This method is used to analysis the efficiency of each fund in a business activity. While analysing the return of capital employed of both the companies, it can be analysed that Forth’s return on capital employed is 21.01% which show the high rate of return on capital invested in various financial funds. On the other, return on capital employed of Clyde Company is 4.94% which showed the low return rate of capital invested. Hence, by comparing both the two companies, it is clear that Clyde is a company which has low return which shows the disability of the form to make any financial expenses during the financial activity in a business.

# EFFICIENCY ANALYSIS

## Account Receivable Collection Period

The account receivable method is used to make a complete analysis of time allowed by the company and also estimate the real time taken by them. From the above table, it can be analysed that collection period which is related to the account receivable of Forth company is 45.2 days (Levy, 2015). On the other hand, Clyde receivable collection period is 57.7 days. Hence, it is clear that Clyde Company take high time to make an account receivable. It is clear that efficiency of management of Forth company y is good as compare to the Clyde Company’s efficiency.

# INVESTMENT APPRAISAL METHOD

To make an effective investment decision it is essential for the investor to make a right choice of the correct appraisal method. There are mainly three appraisal method which is payback period method, internal rate of return and net present value. All these method’s helps the investor to make a right judgement of investment fund which provide a good return on their invested capital. Hence, it can be said that this methods is suitable for the investor to make a good investment in financial funds.

## Payback period method

This method is also known as a recover period method which recover all the initial outlay which is related to the outflow of the cash. It is essentials for the method that all the payback period is must be less than to the project’s life.

**Advantage**

* It is trouble-free to employ because of effortless calculations that are associated to ready money inflows and cash outflows.
* It is imperative for top the complete cash outflow from the cash inflows

**Disadvantage**

* It is not by means of moment price of currency that is imperative for the stretched moment projects (Arrow and Lind, 2014).
* It is not think money inflows following pay off age that is significant for selecting the uppermost hard cash inflows projects.

## Internal Rate of return

It is method by which a manage is able to make a correct decision which is related to the rate of earning by the project. In which higher rate of return is used to take a right selection of the capital fund.

**Advantage**

* It is simple to make use of since of trouble-free calculations that are connected to money inflows and hard cash outflows.
* It is imperative for estimating the velocity of arrival on invested finance.

**Disadvantage**

* It is difficult to estimate the required rate of return for the comparison purpose.
* It is not able to select the best project that has the highest amount of cash inflows over the cash outflows.

## Net present value

This is a method by which actual value of the operation can be analysed for the company by the manager (Camin, Bontempo, Perini and Piasentier, 2016). It includes various inflows and outflow of the cash so that each and every expenditure and income will be recorded effectively. In this, the investment decision is taken by the investors which are totally based on the higher cash inflows over the outflow of the cash in a firm.

**Advantage**

* It is functional to regard as the moment in time charge of the currency is imperative for the extended expression projects.
* It is significant for selecting the maximum money inflows more than the currency outflows supplier projects.

**Disadvantage**

* It is hard to approximation the necessary velocity of arrival for the scheming the in attendance worth.
* It is not capable to choose the most excellent projects that has dissimilar occasion surround (Petruzzo, Gazarian, Kanitakis, Parmentier, Guigal, Guillot, Morelon and Badet, 2015).

Hence, by analysing the various merits and merits of net present value, it is clear that it includes all; the value and estimation of facts which is related to the present price. Thus, it is useful technique for a company to make a correct estimation of the cash requirement for successful operation of an activity. It is clear that all the ratio analysis and its methods are useful to make a correct investment decision for the investor. It is good approach to analysis the actual financial of a company.

# FACTOR ANALYSIS

It is a process which creates an option to the investors to make a correct choicde4 for making the investment of their capital between two companies. While analysis the factor and taking a correct investment decision, growth rate is an important factor which is highly related to the operation of a firm. Hence, it can be said that it is essential for the team members to select an appropriate strategy which is highly targeted with the growth of a company (Tsai, Bertoni, Hernandez-Boussard, Telli and Wapnir, 2016). The business to be acquired has been developed using different sources of funds, or it has managed to grow and increase its business through the same business. For this purpose, companies’ financial statement can be observed. Furthermore, ratio analysis also used to make a correct evaluation of the success and financial position on a firm. It also shows their fractional changes in the profitability of a company which is high and low as per the rate of return. Hence, it can be said that fractional changes in the profit highly affects the returns of the shareholder’s capital. Hence, the shareholders will remain satisfied and thereby, increase productivity of a company.

It is clear that to make a complete analysis of the target company, it is essential for the manager to adopt some leadership skills because the success of manager is highly relayed to the work of the team members. Moreover, the leadership skills of the members of Target Company must be ascertained. It helps in analysing the manner in which work is undertaken in a company and the manner in which execution of work takes place. It is important that management players must be aware of the business in which they are planning to invest. The company must be fully responsive of the market strategy, products and military existing by the aim corporation. It helps in formative its marketplace split and friendliness. It is also important for the management side to collect in sequence from clients in relation to the concern. It will help the organizer to establish the variety charge of merchandise complete by Target Company in a marketplace. Last but not least, the production policies and any trouble linked with implement such policies have to be strong-minded. It can, consequently, be fixed that good sympathetic of a commerce is necessary by the management side previous to creation some asset (Bay, Chan and Walczyk, 2015).

# CONCLUSION

From the above detailed report it can be concluded that ratio analysis is a process which is useful to make as correct financial decision for the company. It is useful strategy which is beneficial for both investor and company in a great extent. This report described the role of ratio analysis. By taking the example of Forth and Clyde Company, it explained the analysis of financial trends of a company which is favourable on the side of Forth Company. By analysing this, it can be concluded that Forth Company is in good financial condition. At last, it also described the factor and profitability analysis by which an investor will be able to make a right investment decision.

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