CHAPTER FIVE

SUMMARY AND DISCUSSION

5.1 INTRODUCTION

Business ratios are the guiding stars for the management of enterprises; they are helpful to managers in directing them towards the most beneficial long-term strategies as well as towards effective short-term decision making. Therefore, proportionality assumption of financial ratios is vital in financial statement analysis because its provides the fundamental to financial statement analysis.

5.2 SUMMARY AND DISCUSSION

The objective of this study concentrates on testing the proportionality assumption of financial ratios for the counters in the KLSE for the period between years 1988 to 1999 and also the ability of financial ratios in company performance prediction.

The findings of this study revealed that the stocks in the KLSE fulfil the proportionality assumption of financial ratios, where 80% of the cases satisfy this assumption. Nevertheless, this study also detected problems of heteroscedasticity and normality in the variables. Various methods have been used to rectify the heteroscedasticity problem and yet none of the test has performed any better than

the original model (REG model). As mentioned earlier, heteroscedasticity can take many forms, and it is not obvious which of these forms should be used to devise a standard test. In addition, heteroscedasticity can be pure or impure and it can also cause non-normality in the variables.

Part Two of this study examines the ability of financial ratios in company performance prediction. The outcome of this study also confirmed that the financial ratios managed to predict more than 60% of the company performance measured by EPS and RPS. Besides that, we also discovered that assets are an important element in forecasting the company performance.

This study further assured us that the KLSE does satisfy the weak form of the EMH, where the past price movements is fully reflected in current market prices. We need to emphases that if every investor believes a market is efficient, then the market would not be efficient because no one would analyse stocks. Because the market follows the weak form of the EMH, the more knowledgeable investors can strive to outperform the less knowledgeable ones.

However, there are some limitations and shortcomings that need to be considered in this study or for future research. If one is to compare the company's performance with that of its exact industry counterpart, there are many possible variables – other than size – which might influence the profile and decision of what he/she should consider when analysis is being carried out. They are:

(1) Age of the business. A business that is one year old seldom has the same characteristic as one that has been operating for 30 years.

(2) Geographical factors. There are often differences of consequence between a company in Kuala Lumpur and its industry counterpart in Terengganu.

(3) Community influence. The circumstances facing a retailer in a large city area (e.g. Kuala Lumpur, Johore Bahru or Penang) are markedly different from those of a store owner in a rural outlet.

For financial ratio in particular, it is rather difficult to evaluate the accounting process without a sound awareness of the uses to which accounting information is being put to. In addition, a conceptual knowledge of finance theory is not of much practical use without some appreciation of the information base on which financial decisions are made. In addition, there are some practical problems when one attempts to carry out a ratio analysis and these include:

(1) Ratio selection

(2) Accounting estimation

(3) Unavailable data

(4) Unsynchronised data

(5) Non-standardised accounting

(6) Negative numbers

Obviously, there are some other useful financial ratios in financial statement analysis, such as Price Earning Growth (PEG), Enterprise Value/Earnings before Interest Income, Depreciation and Associates

(EV/EBITDA), Net Tangible Assets (NTA), Net Gearing and etc, which are also useful in company performance prediction in real world analysis. These ratios require a thorough understanding of the financial statements and some computations are required to calculate the ratios. Due to the lack of detailed information and difficulty in data collection, only commonly used ratios are collected in this study.

As mentioned in Chapter Four, sectorial analysis would be useful when time and financial ability are assets in carrying out the analysis. In this study, only Profit and Loss Account, Balance Sheet and Cash Flow Statement are taken into consideration in data collection. These financial statements only provide standard and limited information. In future research, some comprehensive data that include the notes of the account should be taken into consideration in data collection when one aims to collect more information on some complicated financial ratios such as EV/EBITDA, Net Gearing, etc. Due to the time limitation, budget and also the information available to the public, it is rather difficult to collect data in detail. Moreover, there are not many counters in any sector with sufficient information for us to carry out the analysis. Thus, sectorial analysis in detail is omitted in this study.