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SOLVENCY AND PROFITABILITY ANALYSIS - A CASE STUDY OF BAJAJ FINANCE LIMITED

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ABSTRACT

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Solvency and profitability are two terms that are interrelated each other, or solvency and profitability ratios are two sides of the same coin to be more specific, these two are the stepping stones for the many stakeholders who are directly or indirectly connected with the company to make their respective decisions. We can also say that there is a relationship between a firm's solvency and its profitability.

In this paper an attempt have been made to know the solvency and profitability position of Bajaj Finance Limited and effort is also made to know the relation between solvency and profitability of the company. Against these back ground, the study is composed in four parts first part includes Introduction, Objectives of the study, Research Hypothesis, Research methodology, second part consists of data analysis and discussion, third part shows Theoretical framework of the study and the, forth part reveals findings followed by recommendations and conclusion of the study, limitations of the study. The results of the study shows that there is a negative correlation between short-term solvency with profitability and long term solvency is positively correlated with profitability but interest coverage ratio shows negative correlation with Return on capital employed for the study period.

KEY WORDS: ***Current ratio, Debt equity ratio, Return on equity, Return on capital Employed, Return on asset.***

PART – I
INTRODUCTION

A company is rarely able to run only on shareholder funds. There is usually a debt component (often long-term and short-term), which is used to finance the company's operations and expansion potential. Solvency ratios assist stakeholders, investors, suppliers, and creditors in determining the company's capacity to repay debt or satisfy both short-term and long-term financial obligations. The measure is extremely beneficial to lenders, potential investors, suppliers, and any other organization interested in doing business with a specific company. To establish whether an entity is financially sound, it normally compares its profitability to its obligations. In this aspect, a greater or stronger solvency ratio is desired because it is an indicator of financial strength. A low ratio, on the other hand, reveals possible financial difficulties in the future.

Profitability refers to a company's profits or gains in comparison to its expenses. Thus, profitability analysis refers to the process of calculating or analyzing a company's profits. It assists firms in identifying their revenue streams and areas where they can cut costs to maximize profits. Many stake holders are interested in knowing the solvency and profitability condition of the company for taking decision even prospective investors are also very much interested to evaluate solvency and profitability position of the company for investment purpose

This paper attempts to know the solvency and profitability position of Bajaj Finance Limited and effort is also made to know the relation between solvency and profitability of the company. Against these back ground the study is composed in four parts **first part** includes Introduction, Objectives of the study, Research Hypothesis, Research methodology, **second part**, shows Theoretical framework of the study and **third part** consists of data analysis and discussion and the, **forth part** reveals findings followed by Suggestions, conclusion, and , limitations of the study.

OBJECTIVES OF THE STUDY

1. To analyze short term and long term solvency position of the Bajaj Finance Limited
2. To analyze profitability position of Bajaj Finance Limited
3. To know the relationship between solvency ratio and profitability ratio of Bajaj Finance Limited.
4. To offer suggestions in the light of the findings**.**

RESEARCH HYPOTHESIS

H0 There is Negative relationship between current ratio and ROE
H1 There is Positive relationship between current ratio and ROE
H0 There is Negative relationship between current ratio and ROCE
H1 There is Positive relationship between current ratio and ROCE
H0 There is Negative relationship between current ratio and ROA
H1 There is Positive relationship between current ratio and ROA
H0 There is Negative relationship between debt equity ratio and ROE
H1 There is Positive relationship between current ratio and ROE
H0 There is Negative relationship between debt equity ratio and ROCE
H1 There is Positive relationship between current ratio and ROCE
H0 There is Negative relationship between debt equity ratio and ROA
H1 There is Positive relationship between current ratio and ROA
H0 There is Negative relationship between Interest Coverage ratio and ROE
H1 There is Positive relationship between Interest ratio and ROE
H0 There is Negative relationship between Interest coverage ratio and ROCE
H1 There is Positive relationship between Interest ratio and ROCE
H0 There is Negative relationship between Interest coverage ratio and ROA
H1 There is Positive relationship between Interest ratio and ROA

RESEARCH METHODOLOGY

Collection of Data: the study is conducted based on secondary data. Data are collected from the various sources. Such as websites, research articles, books, annual reports etc.

Period of the Study: The study covers five years period from 2017-18 to 2021-22.

Sample Size: Study is confined to only one company that is Bajaj Finance Limited.

Tools Used : Ratio analysis tools are used to know the solvency and profitability position of Bajaj Finance Limited for this purpose three solvency ratios are used they are Current Ratio (for short term solvency), debt – equity ratio and Interest coverage ratio(for long term solvency). For profitability analysis three profitability ratios (based on investment) are considered such as Return on equity, Return capital employed, Return on assets and simple statistical tool average and correlation analysis is used to test the hypothesis.

PART - II

THEREOTICAL FRAMEWORK

CURRENT RATIO

Current ratio is a ratio between company's current assets and current liability. The bigger is the ratio the better. Because bigger number indicates that the company has more current assets for every rupee of its current liability. it is to be calculated in the following way:
Current Ratio = Current Assets/.Current Liabilities

DEBT EQUITY RATIO

This ratio also highlights the level of total debt of a company relative to its net worth or equity. The lower is the ratio, better is the solvency level of the company. This ratio is calculated with the below formula:
Debt equity ratio = Total Debt/ Net Worth

INTEREST COVERAGE RATIO

The Interest coverage ratio is a financial ratio that is used to determine how well a company an pay the interest on its outstanding debts. The Interest coverage ratio is commonly used by lenders, creditors and investors to determine the riskiness of lending capital to a company. The interest coverage ratio is calculated by following equation:
Interest Coverage Ratio = Earnings before interest and taxes/ Interest expenses

RETURN ON EQUITY

Return on equity is a measure of a company's financial performance. It is calculated by dividing net income by shareholders equity. ROE is a way of showing a company's return on net assets. .High ROE is a symbolic of higher shareholders return. Formula for ROE is shown as under:

Return on Equity = Net Profit / shareholder's fund

RETURN ON CAPITAL EMPLOYED

Return on Capital Employed, a profitability ratio, measures how efficiently a company is using its capital to generate profits. The return on capital employed metric is considered one of the profitability ratio and is commonly used by investors to determine whether a company is suitable to invest in or not. The following formula is used to calculate return on capital employed:

Return on Capital Employed = Earnings before Interest and Taxes/Capital Employed

RETURN ON ASSET

The return on assets is a profitability ratio that reflects the efficiency at which a company utilizes its total assets to generate more net earnings; it is to be calculated by using following formula:

Return on Asset = Net Income/ Average Total Assets

PART - III

DATA ANALYSIS AND DISSCUSSION

The result and analysis of the entire study is represented in the following way:

TABLE NO-1 SHOWING SOLVENCY ANALYSIS OF BAJAJ FINANCE LIMITED FOR THE YEAR 2017-18 TO 2021-22

(IN TIMES)

YEAR	CURRENT RATIO	DEBT EQUITY RATIO	INTEREST COVERAGE RATIO
2017-18	1.66	3.42	1.88
2018-19	3.06	5.16	1.93
2019-20	2.87	4.02	1.77
2020-21	3.41	3.57	1.64
2021-22	3.67	3.78	2.01
AVERAGE	**2.93**	**3.99**	**1.85**

SOURCE : Annual Report of Bajaj Finance Limited

The above table shows that the current ratio of Bajaja Finance Limited for the study period 2017-18 to 2021-22. The current ratio for the study period is in fluctuating trend and which ranges from 1.66 s to 3.67 times. The highest current ratio of 3.67times was reported in the year 2021-22 as against 1.66 times in the year 2017-18. The average current ratio is 2.93 which are good enough to cover the short term liabilities but it shows above the standard current ratio of 2:1. The debt equity ratio of Bajaja Finance Limited is fluctuating and which ranges from 3.57 to 5.16 times and highest debt equity ratio was reported in the year 2018-19 and less in the year 2020-21. The average debt equity ratio is nearly 4 times which is over and above the standard debt equity ratio of 2:1 that means Bajaja Finance Limited has used more debt as against the equity. The interest coverage ratio of Bajaja Finance Limited ranges from 1.64 to 2.01times. The highest interest coverage of 2.01 times is reported in the year 2021-22 as against the 1.64 times in the year 2020-21. The average interest coverage ratio is 1.85 times. Generally, interest coverage ratio 1.5 times moderate and above 3 times is to be regarded as best, so, the Bajaj Finance Limited interest coverage ratio is moderate.

TABLE 2 SHOWING PROFITABILITY ANALYSIS OF BAJAJ FINANCE LIMITED FOR THE YEAR 2017-18 TO 2021-22

YEAR	RETURN ON EQUITY (IN %)	RETURN ON CAPITAL EMPLOYED (IN %)	RETURN ON ASSET (IN %)
2017-18	16.16	13.62	3.07
2018-19	20.28	15.21	3.21
2019-20	16.28	15.55	3.2
2020-21	11.97	12.63	2.57
2021-22	16.7	12.39	3.3
AVERAGE	**16.28**	**13.88**	**3.07**

From the above table we come to know that the profitability analysis of Bajaj Finance Limited for the study period from 2017-18 to 2021-22. The return on equity of Bajaj Finance Limited is ranging from 11.97% to 20.28 %. The highest return on equity is reported in the year 2018-19 and lowest in the year 2020-21. The average return on equity is 16.28%, generally investors expect at least 15% return on investment. So, the Bajaja Finance Limited earned good amount of return to their shareholders during the study period. The return on capital employed of Bajaj Finance Limited ranges from 12.39% to 15.55%. The highest return on capital employed was in the year 2019-20 and less in the year 2021-22. The average return on capital employed is less as compared to ROE which shows that the Bajaj Finance Limited has not earned good amount of profit to satisfy their capital provider. Return on asset of Bajaja Finance Limited is fluctuating trend which ranges from 2.57% to 3.21% the highest return on asset of 3.21% was reported in the year 2018-19 and lowest of 2.57 % in the year 2020-21. The company has not generated enough Amount of return on asset, that means company has not utilized available assets in optimal way.

CORRELATION BETWEEN SOLVENCY AND ROFITABILITY OF BAJAJ FINANCE LIMITED FOR THE STUDY PERIOD 2017-18 TO 2018-2001-22

	ROE	*ROCE*	*ROA*	*CURRENT*	*D/E*	*INTEREST COVERAGE*
ROE	1					
ROCE	0.591488768	1				
ROA	0.818492598	0.405852792	1			
CURRENT	-0.118561463	-0.288648525	-0.065660336	1		
D/E	0.792941602	0.645998994	0.408564482	0.24067115	1	
INTEREST COVERAGE	0.757148137	-0.013022834	0.847986573	-0.0116458	0.3222	1

EXCEL: DATA ANALYSIS TOOL USE

The above table is analyzed in the following way:

- Negative correlation between current ratio and all profitability ratios.
- there is Negative correlation between Interest Coverage ratio with Return on Capital employee
- There is a strong positive correlation between Debt equity ratio and Return on Equity is 79%
- There is a positive correlation between Debt equity ratio and Return on capital employed for the study period.
- There is a positive correlation between Debt Equity ratio and Return on asset.
- There is Negative correlation between Interest coverage ratio and Return on capital employed.
- There is a positive correlation between interest coverage ratio and return on asset ratio is

PART - IV

FINDINGS OF THE STUDY

The following findings are found from our study are as under

NO.	HYPOTHESIS	RESULTS	TOOLS
Ho	There is Negative relationship between current ratio and Return on equity	Accepted	Correlation
H1	There is positive relationship between current ratio and Return on equity	Rejected	Correlation
Ho	There is Negative relationship between current ratio and ROCE	Accepted	Correlation
H1	There is Positive relationship between current ratio and ROCE	Rejected	Correlation
Ho	There is Negative relationship between current ratio and ROA	Accepted	Correlation
H1	There is Positive relationship between current ratio and ROA	Rejected	Correlation
Ho	There is Negativ relationship between debt equity ratio and ROE	Rejected	Correlation
H1	There is Positive relationship between debt equity ratio and ROCE	Accepted	Correlation

Ho	There is Negative relationship between debt equity ratio and ROCE	Rejected	Correlation
H1	There is Positive relationship between debt equity ratio and ROE	Accepted	Correlation
Ho	There is Negative relationship between debt equity ratio and ROCE	Rejected	Correlation
H1	There is Positive relationship between debt equity ratio and ROE	Accepted	Correlation
Ho	There is Negative relationship between Interest coverage ratio and ROE	Rejected	Correlation
H1	There is Positive relationship between debt equity ratio and ROE	Accepted	Correlation
Ho	There is Negative relationship between Interest coverage ratio and ROCE	Accepted	Correlation
H1	There is Positive relationship between debt equity ratio and ROA	Rejected	Correlation
Ho	There is Negative relationship between Interest coverage ratio and ROA	Rejected	Correlation
H1	There is Positive relationship between debt equity ratio and ROA	Accepted	Correlation

SUGGESTIONS

1. Based on the study we suggest that the average debt equity ratio is nearer to 4 times as against the standard debt equity ratios of 2:1 it is too high. So, company has to reduce debt capital to minimum extent in order to get ease from interest payment.
2. Average current ratio of 3.93 times it is too high that means Bajaj Finance limited is good enough to cover short term obligations. But it should not be more than standard ratio of 2:1. As it is finance company make strategies to park excess liquid cash in profitable and growth Investment Avenue to avoid excess liquidity.

CONCLUSION

According to the study, short term solvency is negatively correlated with all profitability ratios and long term solvency ratios, are positively correlated with all profitability ratios, and interest coverage ratio is positively correlated with ROE and ROA except as an exception, interest coverage ratio is negatively correlated with ROCE. The analysis will assist all stakeholders in making their respective decisions by taking into account the association between the company's solvency and profitability. Further it is an academic knowledge which adds to the knowledge of academicians, finance students, researcher. Finally, when long-term solvency ratios are positively associated with profitability, it indicates that the company's performance is good.

LIMITATIONS OF THE STUDY

The following are the limitation of our study

1. Study considers only secondary data no primary data is used.
2. There are so many metrics are there to assess and analyze solvency and profitability position of the company but in our study we used only short term solvency cum liquidity, current ratio is used for short term solvency and for long term solvency ratios, two ratios used are debt equity ratio and interest coverage ratio. For the purpose of profitability we considered the profit related with the investment perspective not the profit with sale perspective.
3. Non-financial performances which affect the business are not considered for our study.
4. Our findings and suggestions are restricted to the study period only.

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