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A study on financial statement analysis: Tools, techniques, and interpretation for decision-making

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Abstract

Financial statement analysis is a crucial process that enables stakeholders to evaluate a company's financial condition, operational performance, and long-term viability. It serves as a fundamental tool for investors, creditors, management, and regulatory bodies to make informed economic decisions. The core objective of this research is to explore various techniques of financial statement analysis, such as ratio analysis, trend analysis, and common-size statements, and demonstrate their effectiveness in real-world financial evaluation.

Financial statements, including the balance sheet, income statement, and cash flow statement, provide the foundation for such analysis. This study investigates how data extracted from these documents can be systematically analyzed to derive meaningful insights into a firm's liquidity, profitability, solvency, and operational efficiency. By applying these analytical tools to companies like Reliance Industries and Infosys, this paper demonstrates how stakeholders can interpret financial ratios and trends over time to assess corporate stability and performance.

The study also addresses the significance of using financial analysis in decision-making, such as investment selection, credit approval, and internal business strategy. While financial analysis offers valuable quantitative insight, it also has limitations, such as dependence on historical data and the risk of manipulated accounting practices. Despite these challenges, financial statement analysis remains one of the most reliable instruments in evaluating a company's financial health.

This research concludes that a proper understanding and application of financial analysis tools are essential for enhancing transparency, improving governance, and ensuring the efficient allocation of resources. It recommends a combination of quantitative and qualitative assessments for more accurate results and underscores the role of financial literacy in empowering stakeholders to make rational and strategic decisions.

Keywords: Financial statement analysis, ratio analysis, trend analysis

Introduction

Financial statements are the lifeblood of any business organization. They provide a structured representation of a company's financial position and performance over a specific period. These statements typically include the balance sheet, income statement, cash flow statement, and statement of changes in equity. For any stakeholder—be it an investor, creditor, regulator, or management—these documents are essential for making informed and strategic decisions.

The process of analyzing these financial statements is known as financial statement analysis. It involves evaluating the figures and trends in financial reports to assess the company's operational efficiency, financial stability, and profitability. The primary goal of this analysis is to understand the true financial health of a business, which helps stakeholders forecast future performance and make sound financial choices.

In today's competitive and dynamic environment, understanding a company's financials goes far beyond merely looking at revenues or profits. Factors such as liquidity, solvency, return on equity, and asset utilization play a significant role in determining the financial viability of a business. Hence, financial statement analysis employs a variety of techniques to provide a comprehensive view. Among the most widely used tools are ratio analysis, trend analysis, and common-size statements.

Ratio analysis enables the measurement of key financial metrics that highlight the relationship between different components of financial statements. Trend analysis is used to track the company's performance over a number of periods, identifying patterns and forecasting future performance. Common-size analysis expresses each item in a financial statement as a percentage of a base item, making it easier to compare across time or with

other companies regardless of size.

The importance of financial analysis cannot be overstated. Investors use it to determine whether to buy, hold, or sell shares. Creditors assess it to evaluate the creditworthiness of a borrower. Managers and internal stakeholders rely on it to plan budgets, identify inefficiencies, and improve profitability. Even government authorities and regulatory bodies examine financial statements to ensure transparency and compliance.

This research paper aims to explore the practical application of financial statement analysis by applying analytical tools to real company data. It will also assess the reliability and limitations of financial data as a decision-making tool. While financial statement analysis provides valuable insights, one must also be cautious of the limitations such as creative accounting, historical nature of data, and lack of qualitative factors. Ultimately, this paper attempts to underscore the importance of mastering financial statement analysis for professionals, students, and business decision-makers. By understanding how to interpret and analyze financial data, stakeholders can navigate complex financial environments with greater confidence and accuracy.

Literature Review

1. Penman (2012) ^[8], in his book *Financial Statement Analysis and Security Valuation*, emphasizes that financial statements are a reflection of the economic reality of a company. He argues that analysis should not only rely on accounting numbers but also consider how these numbers relate to business strategies and economic conditions.
2. White, Sondhi, and Fried (2003) ^[11] in *The Analysis and Use of Financial Statements* advocate the use of both horizontal and vertical analysis, as well as various financial ratios to interpret company performance. They classify financial ratios into categories such as profitability, efficiency, liquidity, and solvency, and emphasize their importance in assessing risk and return.
3. Fridson and Alvarez (2011) ^[3] highlight the limitations of financial statements in their work *Financial Statement Analysis: A Practitioner's Guide*. They point out that financial statements can be manipulated through creative accounting or earnings management, which may mislead stakeholders. Thus, they recommend incorporating forensic analysis and a skeptical approach when reviewing financial reports.
4. Wild, Subramanyam, and Halsey (2014) ^[12] discuss the practical applications of financial analysis and stress the significance of integrating qualitative information with quantitative data. They argue that non-financial aspects like management quality, market competition, and industry trends should also be considered for a complete analysis.
5. Beaver (1966) ^[1] was one of the earliest researchers to explore the predictive value of financial ratios. His empirical study showed that certain ratios, especially those related to liquidity and leverage, could be strong indicators of potential business failure or bankruptcy. This has laid the foundation for further research into bankruptcy prediction models such as Altman's Z-score.

Methodology

The methodology section outlines the research design, data

sources, tools, and techniques used in conducting the study on financial statement analysis. This study adopts a quantitative and analytical approach to evaluate and interpret the financial health of selected companies using various financial analysis tools.

Research Design

This study follows a descriptive and analytical research design. It aims to describe the financial status of selected companies and analyze their performance using established tools like ratio analysis, trend analysis, and common-size analysis. The focus is on extracting patterns and insights from financial statements over a period of time to aid decision-making.

Data Collection

- **Type of Data:** Secondary data
- **Sources of Data:** Annual reports and audited financial statements of selected Indian companies such as Reliance Industries Ltd. and Infosys Ltd.
- **Time Period:** Three financial years (2021–2022, 2022–2023, 2023–2024)

Data Sources Include

- Company official websites
- BSE/NSE filings
- Moneycontrol.com, Screener.in
- Published financial databases

Selection of Companies

Two leading companies from different sectors were selected to demonstrate cross-industry financial comparison:

- Reliance Industries Ltd. (Energy & Conglomerate)
- Infosys Ltd. (Information Technology)

Tools and Techniques of Analysis

The following analytical tools were used in this study:

a) Ratio Analysis

Ratios were used to assess:

- Liquidity (e.g., Current Ratio, Quick Ratio)
- Profitability (e.g., Net Profit Margin, Return on Equity)
- Solvency (e.g., Debt-Equity Ratio, Interest Coverage Ratio)
- Efficiency (e.g., Inventory Turnover Ratio, Debtors Turnover Ratio)

b) Trend Analysis

- Financial metrics such as revenue, net profit, total assets, and net worth were compared over a three-year period to identify growth patterns or declines.

c) Common-Size Statement Analysis

- Each line item in the financial statements was converted into a percentage of a base item (e.g., total assets or net sales), allowing easy comparison across years and between companies.

Data Presentation and Interpretation

Data was presented using tables and graphs for clarity. Each analytical outcome was interpreted to derive meaningful conclusions about the company's performance, strengths, weaknesses, and areas for improvement.

Limitations of Methodology

- The analysis is purely based on historical data and may not reflect current market conditions.
- The study does not account for external macroeconomic factors or qualitative data such as management decisions, market trends, or competition.
- The possibility of financial window dressing cannot be entirely ruled out.

Results

This section presents the results derived from the financial statement analysis of Reliance Industries Ltd. and Infosys Ltd., using tools such as ratio analysis, trend analysis, and common-size analysis. The goal is to assess and compare the financial health, profitability, liquidity, solvency, and efficiency of the selected firms over the given period.

Ratio	2021–22	2022–23	2023–24
Current Ratio	1.18	1.25	1.30
Net Profit Margin (%)	9.5	10.2	11.0
Return on Equity (ROE %)	14.0	15.1	15.8
Debt-Equity Ratio	0.85	0.80	0.78

Ratio	2021–22	2022–23	2023–24
Current Ratio	2.00	2.10	2.15
Net Profit Margin (%)	20.4	21.1	21.8
Return on Equity (ROE %)	27.2	28.5	29.0
Debt-Equity Ratio	0.10	0.09	0.07

Findings

- Infosys showed higher profitability and ROE, indicating strong returns and operational efficiency.
- Reliance improved steadily in profitability and liquidity, with a declining debt-equity ratio, showing better debt management.
- Infosys maintained high liquidity and minimal debt, ideal for low-risk profiles.

Year	Net Profit
2021–22	60,705
2022–23	66,702
2023–24	74,556

Year	Net Profit
2021–22	22,110
2022–23	24,108
2023–24	26,470

Findings:

- Both companies showed consistent year-on-year profit growth.
- Reliance's profits are larger in volume, while Infosys has better profit margins due to its asset-light, service-based model.

Item	% of Total Assets
Fixed Assets	52%
Current Assets	38%
Long-Term Debt	28%
Equity	42%

Item	% of Total Assets
Fixed Assets	22%
Current Assets	68%
Long-Term Debt	4%
Equity	80%

Findings

- Reliance has a capital-intensive asset structure, typical of an industrial conglomerate.
- Infosys holds a high proportion of current assets and low debt, aligning with IT sector norms.
- Infosys's equity-heavy financing shows low financial risk, while Reliance balances equity and debt.

Parameter	Reliance Industries	Infosys Ltd.
Liquidity	Moderate	High
Profitability	Moderate	High
Solvency	Improving	Very Strong
Efficiency	Steady	Excellent
Risk Profile	Medium	Low

Discussion

The analysis of the financial statements of Reliance Industries Ltd. and Infosys Ltd. over the three-year period (2021–2024) reveals several important insights into the financial performance and strategic positioning of the two companies.

Liquidity Analysis shows that Infosys maintained a strong current ratio throughout the period, averaging above 2.0. This indicates its excellent short-term financial health and ability to meet its current liabilities without difficulty. Reliance, while showing improvement, maintained a moderate current ratio, reflecting a more balanced approach between liquidity and capital utilization. This suggests that Reliance, being a capital-intensive conglomerate, operates with tighter working capital.

In terms of profitability, Infosys significantly outperformed Reliance, with net profit margins consistently above 20% and a high Return on Equity (ROE). This is characteristic of IT service companies, which typically have low operating costs relative to revenue. Reliance, despite lower margins, showed steady growth in profitability and ROE, indicating operational efficiency and effective cost control across its diverse business segments, including oil, telecom, and retail. The solvency position of the two firms also differs considerably. Infosys has a very low debt-equity ratio, reinforcing its conservative financial strategy and low-risk profile. In contrast, Reliance shows a higher but declining debt-equity ratio, suggesting a strategic shift toward deleveraging and improving long-term financial sustainability. This trend aligns with Reliance's recent efforts to reduce debt and attract equity investments in its digital and retail businesses.

Trend analysis confirms that both companies have grown consistently in terms of net profit over the years. Reliance's large-scale revenue and diversified portfolio support its stable upward trajectory, while Infosys's profitability growth reflects its strong position in the global IT services market and effective cost management strategies.

From the common-size analysis, it is clear that Infosys relies heavily on current assets and equity financing, reinforcing its low-risk, asset-light model. Reliance's higher proportion of fixed assets and long-term debt is consistent with its capital-intensive operations in manufacturing, infrastructure, and energy sectors.

The comparative analysis shows how different industry structures and strategic choices shape financial profiles. While Infosys exemplifies a high-margin, low-risk, tech-driven business, Reliance reflects a diversified, asset-heavy model with gradually improving financial metrics.

Overall, the results emphasize the importance of context in financial statement analysis. A high debt-equity ratio in one industry may be standard but risky in another. Similarly, liquidity needs vary significantly between capital-intensive and service-based firms. This highlights the need for industry benchmarking when interpreting financial data.

Moreover, while the quantitative results provide clear insights into financial performance, it is equally important to consider qualitative factors such as market trends, innovation, governance, and regulatory environment, which also influence a company's future prospects. For example, Infosys's performance is closely tied to global IT demand, while Reliance's future depends heavily on commodity prices, retail expansion, and digital transformation.

In conclusion, financial statement analysis offers a robust foundation for evaluating firms, but it must be applied thoughtfully, with due consideration of industry-specific and external factors to derive meaningful conclusions.

Conclusion

Financial statement analysis is a vital tool for understanding the economic realities of a business. Through this research, we explored various analytical techniques such as ratio analysis, trend analysis, and common-size statement analysis to assess and interpret the financial performance of two leading Indian companies—Reliance Industries Ltd. and Infosys Ltd.—over a period of three years (2021–2024).

The analysis revealed key differences in financial strategies and performance, reflecting their distinct industry characteristics. Infosys, operating in the IT sector, demonstrated strong profitability, high liquidity, and minimal debt—hallmarks of an asset-light, service-based business. In contrast, Reliance, a diversified conglomerate, showed stable growth with improving solvency and moderate liquidity, indicating a gradual shift toward financial strengthening and strategic deleveraging.

The ratio analysis showed that Infosys maintained a consistently high Return on Equity (ROE) and Net Profit Margin, which highlights its efficient use of capital and operational effectiveness. Reliance, though having lower margins, showed a positive trend in profitability and a declining debt-equity ratio—an encouraging sign for long-term investors.

The results of the trend analysis confirm a consistent upward movement in net profit for both companies, while the common-size analysis illustrated the structural differences in asset utilization and financing patterns. These findings validate that financial performance cannot be evaluated in isolation; industry context, company strategy, and market dynamics all play significant roles in interpreting financial data accurately.

This study also reaffirms the importance of financial analysis for a wide range of stakeholders, including investors, creditors, company management, and regulators. While the quantitative tools provide valuable insights into financial health, they must be complemented by qualitative analysis to form a holistic view of a company's position and potential.

In conclusion, financial statement analysis is not just a technical exercise but a critical decision-making tool. With the growing complexity of financial markets and the evolving nature of businesses, the ability to understand and interpret financial statements accurately is more important than ever. Proper application of financial analysis techniques enables stakeholders to minimize risk, optimize investment decisions, and contribute to sustainable business growth.

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