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Influential Factors of Company Analysis in the Context of Investment

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Abstract

To examine the profitability of the prospective investment avenues stock market analysts are always making use of fundamental analysis, where the need for analysis of fundamental aspects relating to a company arises. Normally, it follows a three-tier methodology viz, economic analysis, industry analysis, and company analysis. Company analysis refers to the process of evaluating a company's profitability, profile and products or services. It is generally used by investors or analysts. It incorporates basic company information, such as the mission statement, goals and values. This paper is an attempt to study the influential factors of company analysis in the context of investment. The major discussions include the need, factors to be considered, required tools based on the nature of the company, etc.

Key words: Company analysis, tools, nature of business, financial planning

1.0 **Introduction**

Stock market operations are often compared to gambling activities. All the winnings here are supposed to be backed by the Goddess of Luck. Investors or participants are to a great extent guided by the sentiments such as faith, phobia, lure, etc. There are soothsayers and wizards who provide advice and strategies to investors. However, rational investors like to play safe. They wish to manage their funds optimally. For these, they need organized information based on scientific methods and techniques. Several contributions to the stock of this knowledge have already been taken place since the inception of stock trading. To examine the profitability of the prospective investment avenues stock market analysts are always making use of fundamental analysis, where the need for analysis of fundamental aspects relating to a company arises. Normally, it follows a three-tier methodology viz, economic analysis, industry analysis, and company analysis. This paper attempts to examine the company analysis, its feasibility, the vital areas to be covered based on the nature of the company, company-wise tools requirements, etc.

1.2 Rationale for Company Analysis

Analysis of a company consists of measuring its performance and ascertaining the cause of this performance. When some companies have done well irrespective of economic or industry failures, this implies that there are certain unique features for these companies which had made it a success. The process of identification of these characteristics, whether quantitative or qualitative, is referred to as company analysis.

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1.3 Company Analysis – Factors

As mentioned above, company analysis is a process of identification of unique factors of a company which helps to attain better results even though there are failures in the industry or in economy. These specific factors are categorized into two. They are:

a. Quantitative factors, and

b. Qualitative factors.

1.3.1 Quantitative factors

Quantitative aspects of the company analysis are the financial indicators and operational efficiency indicators.

1.3.1.1 Financial indicators

These are the profitability and financial position indicators analyzed usually through the income statement and position statement of the company respectively.

1.3.1.2 Operational efficiency indicators

These are the capacity utilization and cost-sales efficiency of the company, which includes the marketing potential of the company. The information in these regard can be fetched through annual reports published by the company, financial magazines, newsletters, websites, etc. These reports provide information such as breakup of sales, profits, capital structure, asset mix, etc. Thus, operational efficiency indicators help the prospective investors in analyzing the company performance.

1.3.2 Qualitative factors

These represent aspects which are difficult to quantify, and include management reputation, market position, business model, competitive advantage, corporate governance, etc. Some important qualitative factors are briefly discussed below.

1.3.2.1 Business model

It is related to the activities of the business concern or it tries to find answer to the question of 'how a company makes money'? or 'what does the company do'?

1.3.2.2 Competitive advantage

It means a company is performing better than rivals by doing different activities or performing similar activities in different ways.

1.3.2.3 Management and its reputation

Companies commonly rely up on management to steer towards financial success. The management feels can be achieved by conference calls, discussions, analysis, past performance, etc.

1.3.2.4 Corporate governance policies

The aim of these policies is to ensure that proper checks and balances are in place, making it more difficult for anyone to conduct unethical and illegal activities.

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1.4 Tools for company analysis

Company analysis involves choice of investment opportunities within a specific industry that comprises of several individual companies. The selection of an investible company depends on the future performance expectations. Company analysis includes understanding the competitive environment, examining the levels of competition, demand, and profitability factors, etc. Here all the qualitative and quantitative factors need to be considered. Only the fortunate analysts are able to identify or examine the qualitative factors as these are rarely publicly available. However, the economic forecasting and surveys play a great role in making available the economic conditions and market forces to the knowledge of analysts.

The Quantitative factors such as financial indicators and operational efficiency indicators can be arrived at by using the popular ratio analysis and other techniques as detailed below.

1.4.1 Ratio analysis

Ratio analysis is a quantitative analysis of information contained in a company's financial statements used to evaluate various aspects of a company's operating and financial performance such as its efficiency, liquidity, profitability and solvency. The trend of these ratios over time is studied to check whether they are improving or deteriorating.

The contents of the statements differ according to the nature of business of the company. Eg: Manufacturing business, Service Company, Trading Company, etc.

1.4.2 Revenue / Sales growth

Stock analysts need to forecast revenue and growth to project what expected earnings will be. Forecasted revenue and growth projections are important components of security analysis, often leading to a stock’s future worth.

1.4.3 Company management

Most investors think that it is important for a company to have a good management team. The problem is that evaluating management is difficult as so many aspects of the job are intangible. It is clear that investors cannot always be sure of a company by only poring over financial statements. There is no magic formula for evaluating management, but following factors should be noticed for the same.

a. The management job, compensation, etc.

b. Length of tenure

c. Strategy and goals

d. Insider trading

1.5 Methodology

As far as companies are concerned fundamental factors which influences the profitability and other related areas cannot easily be identified. These differ from company to company so that a study on these factors from the perspective of various companies is challenging because of identification of various aspects and narrative calculations.

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1.6 Conclusion

This paper is an attempt to study the influential factors of company analysis in the context of investment and is descriptive in nature. There are plenty of quantitative as well as qualitative factors which influence the performance of a company. However, qualitative factors play a vital role in this regard.

1.7 Implications

The implications of this study can be widespread. The identification methods of various factors are compromising their integrity in some areas relating company. The quality of management is a determining factor in stock price movements. All these noticing that there should be uniform, systematic and comprehensive method which can be applied to all the companies where the need for fundamental analysis arises.

1.8 Limitations of the Study

The present study suffers from the limitation that it is not often practical to identify the qualitative factors affecting the performance of the company and hence a true-sense picture of the company cannot be portrayed. This study provides only a theoretical background / backdrop to the concept of company analysis. There is dire need to empirically validation of the qualitative factors using appropriate techniques.

1.9 Scope for Further Research

Different scholars have tried to explain fundamental factors which affect the performance of the company. However, there is no consensus among their opinion.

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