



testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹599 FOR  
1 YEAR

BUY NOW



testbook

# RBI Grade B Banking & Financial Awareness Notes - Last Minute Advanced Capsule

## Ratio Analysis:

Ratio Analysis is an analysis of information related to a company's finance. Ratio Analysis involves using various financial statements such as income statement, balance sheet and cash flow statement to understand and evaluate a company's financial performance as well as its market competency, solvency and profit making capability. Ratios and ratio analysis don't introduce new information previously absent from the financial statements. The purpose of computing ratios is to systematically draw comparisons between various aspects of the financial statements to be able to come up with conclusions.

There are different kinds of ratios used in banking sector. These are:

**Quick Ratio** - Quick Ratio is another way to measure company's liquidity. Quick Ratio is also known as Acid Test Ratio. It the ratio of Quick Assets (cash, bank balance, market securities from short-term, receivables) to the ratio of Current Liabilities. Ordinarily, an acceptable quick ratio is 1:1 as a company can, with it, meets it current claim requirements.

The formula for quick ratio is:

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$





testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹400 FOR  
4 MONTHS



testbook

BUY NOW

**Net Working Capital** - Net Working Capital is an indicator how much more a company's current assets are than its current liabilities. To effectively fulfill company's needs and requirements related to customers, an appropriate NWC is important. Current assets are those which are convertible to cash in the near future (a year's time); whereas, current liabilities are those who have to be paid in the near future (a year's time). NWC allows the company to understand from where the assets are financed. Net Working Capital is also known as Liquid Surplus. In terms of ratio, net working capital will be positive when the current assets exceed the current liabilities and will be negative when the current liabilities exceed the current assets. Ideally, the ratio of NWC should be more than 1:1. This makes the company capable to have an appropriate level of liquidity and use working funds.

**Current Ratio** - Current Ratio is the ratio measuring a company's ability to meet its short-term and long-term requirements. It is the ratio of current assets to current liabilities. The current ratio is 1 if current assets and current liabilities are equal. A ratio of more than 1 indicates that assets are more than liabilities; and similarly, a ratio of less than 1 indicates that liabilities are more than assets. Ratio of 1 shows that the NWC is zero. Moreover, a ratio of less than 1 shows that the financial condition of a company is not satisfactory and a ratio of more than 1 shows that company can successfully pay its long-term obligations. The formula for current ratio is:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

**Debt Equity Ratio** - A company's ability to pay its debts is measured by the relation between funds taken from sources that are not one's own and the capital funds belonging to the owner. Also known as financial leverage ratio, debt equity ratio judges the financial position and health of the company. The formula for debt equity ratio is:

$$\text{Debt Equity Ratio} = \frac{\text{Total Outside Liabilities} + \text{Intangible Net Worth (Cash + Other Intangible Assets)}}{\text{Net Worth (Cash + Other Intangible Assets)}}$$



testbook



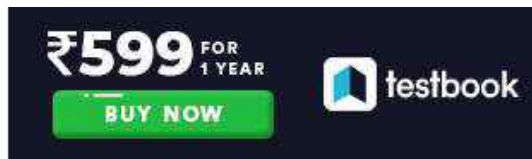
ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹200 FOR  
1 MONTH



testbook

BUY NOW



If the debt equity ratio is very high, it is unfavorable for the company. This is because it means the company is run more by outer sources than by company's own capital. In banks, the acceptable ratio is below 3:1.

**Funded Debt Equity Ratio** - The funded debt equity ratio is used to judge the value of various projects of the company. It is important to see what will be the funded debt equity ratio to finance new project. The formula for funded debt equity ratio is:

$$\text{Funded Debt Equity Ratio} = \frac{\text{Total of Long - Term Liabilities}}{\text{Net Worth}}$$

**Debt Service Coverage Ratio** - Debt Service Coverage Ratio is the ratio that measures a company's capability to pay interest on its debt obligations. According to the conventional banking wisdom, the unit is safer if the coverage is higher.

The formula for DSCR is:

$$\text{DSCR} = \frac{(\text{Net Profit} + \text{Depreciation} + \text{Interest on Loan Term})}{(\text{Interest on Loan Term} + \text{Instalment})}$$

For a loan term, DSCR is understood only for those years over which the loan can be repaid. If the average DSCR over the life of a loan is at an acceptable level, then the company can pay interest on the term loan. The minimum ratio considered sufficient is 1.5.

**Net Profit Margin** - Net Profit Margin tells us about the relationship between the final profits of the company and their sales. This ratio is used to know the total company profitability. A high net profit margin ratio means that the company is working efficiently. The formula for Net Profit Ratio is:

$$\text{Net Profit Ratio} = \frac{(\text{Net Profit}}{\text{Net Sales}}) \times 100$$





testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹400 FOR  
4 MONTHS



testbook

BUY NOW

**Gross Profit Ratio** - Gross Profit Ratio is required to measure the overall profitability of the company. Elements used for calculating Gross Profit Ratio are Gross Profit and Net Sales. The formula for Gross Profit Ratio is:

$$\text{Gross Profit Ratio} = \left( \frac{\text{Gross Profit}}{\text{Net Sales}} \right) \times 100$$

Gross Profit is difference between the cost generated by selling goods and net sales. Gross Profit Ratio shows how properly a company's products are produced. Gross Profit is considered better when it is higher because we calculate it by eliminating the sold good's cost from net sales.

**Cash Ratio** - Cash ratio is the ratio of total cash and cash equivalents (those items that can be transformed into cash instantly in the market) to current liabilities. It shows how enough a company's cash and marketable securities are to do away with the current liabilities.

The formula for cash ratio is:

$$\text{Cash Ratio} = \frac{\text{Cash} + \text{Cash Equivalents}}{\text{Current Liabilities}}$$

**Retained Net Profit** - Retained Net Profit is known by many names such as Plowback Ratio, Retention Ratio and Retained Surplus Ratio. Retained Net Profit is retained earnings relative to total earnings. This profit amount is that which remains after all the dividends have been paid. This profit amount is, then, reinvested in the projects and paid debts with. The formula for Retained Net Profit is:

$$\text{Retained Net Profit} = \left( \frac{\text{Net Income} - \text{Dividend}}{\text{Net Income}} \right)$$

**Return on Investment** - Return on Investment is a ratio of performance primarily used to see how profitable the investment was. Here, the investment gains are compared with the costs investment required. The bigger this ratio, the better the investment is supposed to be. The formula for Return on Investment is:



testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹200 FOR  
1 MONTH



testbook

BUY NOW

**Return on Investment = Net Profit after Interest and Tax  $\div$  Net Tangible**

**Interest Coverage Ratio** - Interest Coverage Ratio measures the capability of a company to pay its interest. This ratio is the same as earnings before interest and taxes divided by obligations related to the interest. The formula for interest coverage ratio is:

**Interest Coverage Ratio = Earnings Before Interest and Tax  $\div$  Interest Obligations**

**Turnover Ratio** - There are different types of turnover ratios. These are given below.

**1. Working Capital Turnover Ratio** - This ratio is used to see how well the company utilizes the working capital which is the amount you get after deducting total current liabilities from total current assets. The formula of Working Capital Turnover Ratio is:

**Working Capital Turnover Ratio = Net Sales  $\div$  Working Capital**

**2. Inventory Turnover Ratio** - This ratio is the relation of cost of sold goods with inventory. It is used to see how well a unit sells its inventory. The more this ratio is, the better the company's inventory management will be. The formula of Inventory Turnover Ratio is:

**Inventory Turnover Ratio = Cost of Goods Sold  $\div$  Average Inventory**

**3. Debtors Turnover Ratio** - This ratio tells the company how effectively it turns the debtors into cash. In the actual workplace, it measures the efficiency of the collection department in companies. It is the relation, thus, between sales and debtors. The formula for Debtors Turnover Ratio is:

**Debtors Turnover Ratio = Net Credits Sales  $\div$  Average Trade Debtors**





testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹400 FOR  
4 MONTHS



testbook

BUY NOW

**4. Creditors Turnover Ratio** - This ratio shows exactly how many times average dues to the supplier are settled. If credit turnover is high, the company must quickly settle all its accounts. If credit turnover is low, credit terms are proper. The formula for Creditors Turnover Ratio is:

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Creditors}}$$

**Price to Earnings Ratio** - This ratio shows how to understand the relation of stock price to company's earnings. This ratio informs you about what will be the market rate for the earnings of the company. The formula for Price to Earnings Ratio is:

$$\text{Price to Earnings Ratio} = \frac{\text{Market Price per Share}}{\text{Earnings per Share}}$$

**Book Value Per Share** - The formula for Book Value Per Share is:

$$\text{Book Value Per Share} = \frac{\text{Ordinary Shareholder's Equity}}{\text{Number of Equity Shares Outstanding}}$$

**Earnings Per Share** - The formula for Earnings Per Share is:

$$\text{Earnings Per Share} = \frac{\text{Net Profit after Tax} - \text{Preference Share Dividend Pay}}{\text{Number of Ordinary Shares Outstanding}}$$

**Market Price per Share** - The formula for Market Price per Share is:

$$\text{Market Price per Share} = \text{Price to Earnings Ratio} \times \text{Earnings per Share}$$

**Dividend per Share** - The formula for Dividend per Share is:

$$\text{Dividend per Share} = \frac{\text{Dividend paid to ordinary shareholders}}{\text{Number of Ordinary Shares Outstanding}}$$

**Earnings Yield** - The formula for Earnings Yield is:

$$\text{Earnings Yield} = \left( \frac{\text{Earnings Per Share}}{\text{Market Price per Share}} \right) \times 100$$

**Dividend Payment Ratio** - The formula for Dividend Payment Ratio is:



testbook



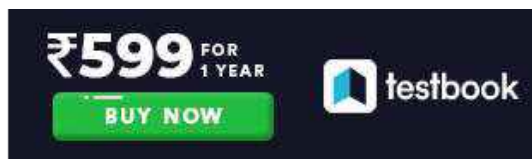
ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹200 FOR  
1 MONTH



testbook

BUY NOW



**Dividend Payment Ratio = Dividend Per Share ÷ Earnings Per Share**

**Market Capitalization** - Market Capitalization is the total market value of the total outstanding shares that belong to a company. The formula for Market Capitalization is:

**Market Capitalization = Number of Ordinary Shares Outstanding × Current**

### **Market Price of One Share**

The market capitalization number is used to determine the size of the company.

**Swap Ratio** - Swap Ratio is the ratio where an acquiring company provides its own shares in exchange for the shares for Target Company in times of acquisition or merger. This ratio calculated by using various other financial ratios given above.

**Marginal Costing** - Marginal Costing is that system of account where variable costs are charged to cost units and the fixed costs of the period are written off in full against the aggregate contribution. Its special value is in decision making.

The 'contribution' in the term "aggregate contribution" is what you get by deducting Marginal cost from sales.

Here are some more articles that might help you prepare for RBI Grade B exam:

**Important Regulatory Bodies in India**

**Important Government Bodies**

**Digital India - All you need to know**

**Basic Budget Concepts for Beginners**

**Know Your Banks – Distressed Banking Sector and NPAs**





testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹400 FOR  
4 MONTHS



testbook

BUY NOW

## Countries & Currencies

## Finance & Banking Abbreviations in PDF

## International Organizations and their Headquarters

## Banks and Headquarters

## Important Points about Demonetization

*To practice questions, click on the link provided below!*

## Practice Questions for Free

*All the best for your exam! Do comment below if you have any doubts or like this capsule and share your doubts with our experts.*



testbook.com

**Go to Testbook Discuss**



testbook



ATTEMPT ALL TESTS  
ACROSS ALL EXAMS

₹200 FOR  
1 MONTH



testbook

BUY NOW