

## **CHAPTER 1: Introduction**

### **1.0 Introduction to Study**

For decades investors have been turning towards eye-catching firms' financial statements in order to gauge the best bet for their deposits. However, to further evaluate the viability of their potential financial placements within the financial industry, a more in depth approach is vital for which ratio analysis arises in hopes of providing an efficient information system (Babalola and Abiola, 2013). Relevant published financial data, usually from the firm's financial statements presents investors with crucial information when published. Risk evaluation, projected rewards, profitability and efficiency are amongst what potential investors attain from the application of ratio analysis prior to placing funds. These figures are then compared either to the prospective firm's previous fiscal years in order to evaluate growth or establish its competitive advantage within the ever growing financial industry to conclude where the firm stands within its market. This will tend to influence investors' decision making as it stands as an indicator of their potential rewards (Almedia et al., 2011).

Dragomir (2007), in his research refers to ratio analysis as being a means of identifying and describing relationships between financial statements items hence, providing a guide as how management rallies its resource. He further states, in conjunction with Almedia, et al, (2011) that its value arises when calculated ratios are compared to the firm's budgeted projections and benchmarked against its market leaders, thus, providing stakeholders with details in categories including risk, profitability, feasibility of investment and liquidity (Dragomir, 2007). By contrast, James (2011), notes that financial ratio analysis is subject to human error from the physical entry of financial data, as well as misinterpretation, such as, an increase in creditor payment period gives the immediate indication that the business is in a financial constraint, unable to pay creditors. However, upon further inspection there is a possibility that the firm has utilized the amount owed

into a fruitful investment, aiding future growth and expansion of operations or research and development (James, 2015). Further, ratio analysis allows decision makers to evaluate the operational health of a company, usually described as its performance in terms of profitability and going concern matters and assesses the passed-on risk level associated with debt financing in order to determine the overall worth of the potential investment (Delen, et al., 2013). Hence, from the projected data financial ratio analysis is a tool applicable for users of companies' financial data in an attempt to gain a thorough insight of current and projected performance by comparing the firm to either its past results or its major competitors in order to make substantial decisions.

Moving forward, the chapter within its segments aims to provide the context of research raised along with its issue, deliver a rationale for the given topic and dictate its research question. This is in addition to clarifying any aims and objectives, providing the framework for the relevant research and the structure for which the project will take in its follow up chapters.

### **1.1 Research Context and Issue**

Due to its impactful success, investors and financial analysts have been keen on the financial data of the major players of the tea industry. Since the year 2016, the tea industry has been consistently exceeding expectations, valuing \$52.1 billion in 2018 and projected to reach \$81.6 billion by the year 2026, with an estimated market growth rate of 6.5% by the year 2024. With its majority demand being green tea, China holds the prominent market share, with herbal teas gaining momentum (Kumar and Deshmukh, 2019). Further, an increase in disposable income paired with a continual increase in health awareness have contributed significantly to the tea culture expansion, especially amongst the millennial population which currently accounts for a sizeable contribution in its increasing sales (Beverage Business World, 2019). As a result, investors have since kept a

close eye for opportunities within the space hoping to allocate funds for impactful future returns, in particular, Tata Global Beverages, a market leader within the industry.

Tata Global Beverages Limited is an Indian based multinational corporation strong holding in Europe, North America and China with a brand presence in at least 40 countries and currently stands as the second largest tea manufacturing company globally, with its major competitors being Nestle and Diana Tea Company (Tata Global Beverages, 2019). Currently, Tata produces and distributes tea, coffee and water with plans to enter the food industry by March 2020 (Sanjai and Alexander, 2018). Its beginnings were a joint venture in 1964 with current tea giant of the time James Finlay, leading to a buy over by 1983. Since then, Tata Global Beverages has acquired leading tea specific firms including Tetley Group Limited, Good Earth and Vitax along with the famous Himalayan Water and Australia's famous coffee brand Map Coffee (Tata Global Beverages, 2019). Also noted is that Tata Global currently stands in a joint venture with Starbucks and is responsible for its Indian branches in accordance with their official website. According to Ajay Misra in the Chairman's Report (2019), the current spike in the health and wellness trend as depicted by the Beverage Business world (2019) serves to benefit Tata's overall portfolio despite its mixed performance for the 2018-2019 year. Misra further notes a six per cent growth in consolidated revenue despite a fall in overall net profit credited mainly due to investments in a variety of new blends, new distribution techniques and efforts to strengthen brand positioning after a noted increase in international competition (Tata Global Beverages, 2019).

Politically, India, headquarters of the firm is highly stable with consistent ruling parties and persons of power, allowing firms to operate comfortably with familiar policies giving Tata Global Beverages an advantage amongst its internationally based competitors (Balasubramanian, 2019). Tata Global benefits economically from India's high dependence of the agriculture sector whereby

they attain easy access to ingredients for products and a reduced delivery charge due to the absence of needing to import items (Food and Agricultural Organization of the United Nations, 2019). Additionally, Tata dominates the market due to its ability to adapt and provide for the ever-changing consumer preference including as of late launching teas with specific health benefits to satisfy the current consumer demand indulged in health awareness previously introduced by Kumar and Deshmukh, (2019), (Tata Global Beverages Limited, 2019). In light of technical innovation, already noted by Misra, (2019), Tata Global has since invested in new technologies with the aim to improve the efficiency of its distribution networks in 2018 according to its annual reports (Tata Global Beverages Limited, 2019). Further, the company adheres to a 34.94 per cent taxation rate in its homeland paired with a tax relief from its North America's operations, while environmentally, Tata is head on with associations fighting climate change, partaking in sustainable sourcing, waste management and focused on community development (Tata Global Beverages Limited, 2019).

Moreover, Tata Global's financial statements are a key player pertaining to ratio analysis and in turn investor decision making. Kumaran (2015), elaborates its importance as an indicator of financial performance due to its depiction of working capital, gains and spending patterns for the period, including borrowings and repayments. He further stresses the importance of ratio analysis in identifying inventory problems, prolonged debtor collections, inability to pay creditors and cash flow problems which are vital information to be disclosed to the firm's stakeholders (Kumaran, 2015) paired with Delen, et al. (2013)'s mentions of going concern and risk. Further rationalization of the research intent will be analyzed in the proceeding chapter segment.

## **1.2 Rationale**

Through the use of ratio analysis, users of financial data can gauge firms' ability to grow, adapt and overcome within the constantly changing macro environment, hence, also determining the flexibility or level of opportunity seizing ability of said company which can impact its overall going concern (Saebi, et al., 2017). This is done by comparing the firm's financial ratios of one year to another as stated by Dragomir (2007) while being aware of economic and industrial shocks within the comparison period. A prime example of this lies with the India government demanding the closure of tea estates from mid-December, 2019 until February 29<sup>th</sup> 2020, for which the market has already seen the pitch in demand for the leaves for manufacture and storage within this time. Thus, at the end of the fiscal year 2020, users of accounting information will be equipped to evaluate the impact and response of the situation paired with the increasing demand for green and specified health benefitting teas on interested tea producing firms (Ghosal, 2019). As a result, potential investors will be able to gauge whether or not the interested firms are suitable for investments based on adaptability.

Moreover, in addition to adaptability, investors are able to gauge their potential financial risk, that is, the manner in which assets are financed. Tesco (2019), refers to this as arising from the ability of firms to meet their debts efficiently and comprising of interest rate risk, credit risk and liquidity risk. This is a prominent aspect of investing in shares due to the implication that common shareholders are the last personnel to be distributed funds, hence, they themselves hold the financial risk of their firm. Thus, financial risk, in accordance with Tesco (2019), is the risk of not being allocated funds depends on the financial performance of the entity and hence its ability to manage their debt (Bebie Traynor, 2019).

Consequently, as with Delen, et al (2013) and Drogomir (2007) it can then be said that ratio analysis is a vital tool for investment decisions due to its scope of analyzing operational aspects of the potential company, as well as evaluation the impacts of macroeconomic forces in terms of adaptability and development. Moreover, the categories of ratios available to users specify individual aspects of operations including those of profitability, liquidity, solvency and valuation (BBC Bitesize, 2019). Ultimately, financial ratio analysis tends to be the most common approach by which investors value their investments mainly due to easily available information and ease of calculations (Morningstar, 2013), which in turn gives rise to the proceeding research question.

### **1.3 Research Question**

Given the preceding information the ensuing research will aim to focus on **“To what extent can Ratio Analysis Influence Investor Decision.”** This entails the researcher seeking to determine whether ratio analysis as an appraisal can convince or deter a potential investor, given the range of categories and ratios available for calculations. Hence, allowing for focus on the firm’s profitability, liquidity, solvency and valuation which gives rise to the project’s aims and objectives.

### **1.4 Aims and Objectives**

#### **Aim:**

To evaluate Tata Global Beverages limited by using ratios pertaining to vital aspects of its operations.

#### **Objectives:**

1. To assess the operational health of Tata Global Beverages Limited using ratio analysis
2. To determine the financial risk level of Tata Global Beverages Limited
3. To calculate whether or not investment in Tata Global Beverages will be fruitful to stockholders