2.3: Who Uses Financial Statement Analysis?

Who uses financial statement analysis? The answer is many different groups of individuals and institutions who are concerned with identifying the health and performance of a company. This includes, but is not limited to the following groups:

Company Management

Managers need to evaluate a variety of ratios in order to properly manage their firm. They need to understand the liquidity situation, how well the company is doing at generating sales from their assets, what the debt picture is telling them, how profitable they are, and how investors are valuing their stock. As such, they need the big picture view provided by all the ratios, an evaluation of the statement of cash flows and common size statements.

Competitors

Like management of our own company, management of our competitors are going to need a big picture overview of our firm (as well as their other competitors) to evaluate their own strengths and weaknesses relative to their competition.

Long-term Lenders

While current and potential bondholders (and other long-term lenders) are going to evaluate many areas covered by financial statement analysis, there are certain areas that are more important and others that are less critical. For example, a current/potential bondholder is not likely to care much about the firm's PE ratio or inventory turnover ratio. On the other hand, debt management and liquidity ratios are going to be a big focus. Profitability ratios are somewhat in the middle. While long-term lenders prefer firms be profitable enough to have a margin of error in generating enough cash flows to meet their interest obligations and repay the principal, they are not really concerned with seeing profitability ratios be on the high end of the industry as they don't benefit from excess profits like stockholders do.

Short-term Creditors

Like long-term lenders, short-term creditors are focused on the firm's ability to repay its liabilities. However, they are less concerned with debt management ratios and more concerned with liquidity ratios. Whether the firm can meet their long-term obligations is less relevant as long as the firm can generate enough cash flows to meet their current obligations.

Stock Investors

Stock investors are going to have more of a big-picture focus than creditors. This is because the firm has to be generating sufficient cash flows, have significant and reliable profitability, meet its debt obligations (as stockholders come after bondholders in the priority of claims), and be able to purchase shares at a reasonable price.