

शोधायतन

वाणिज्य, कला, शिक्षा, समाजशास्त्र तथा ह्यूमेनिटीज पर
आईसेक्ट विश्वविद्यालय की शोध पत्रिका

Shodhaytan

AISECT University Journal of Commerce, Arts,
Education, Sociology and Humanities

Vol.-IV / Issue-VII

UGC Approved Journal

June-2017

शोध के चक्र ज्ञान का मार्ग रचें, लेकिन पहुंचाए
सामाजिक सशक्तिकरण तक



Published By

AISECT UNIVERSITY

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Indexing and Impact Factor :

INDEX COPERNICUS : 48609 (2018)

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SPEAFP Score Card- a tool of the Corporate Star Rating

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ABSTRACT

*Stars are often used as symbols for classification purposes. They are used by reviewers for ranking things and positions such as electronics and electric items, movies, TV shows, restaurants and hotels, Police and military [army and navy for the staffs] and other items which are directly related to environment. The star rating practices are not in use for the companies in India or in the world. But from last one decade some corporate mutual fund houses are using **Star** word for ranking of various mutual fund schemes. In this study I am suggesting a model that examines investors' reliance on financial statement information, their perception of the frequency of fraud occurrence, the importance they place on fraud risk assessment as an investment activity, and, ultimately, their use of fraud red flags. . For this purpose I have developed a score card which can help in the corporate rating. This paper mainly discussed the importance of SPEAFP score card in star rating. Stars are often used as symbols for classification purposes. They are used by reviewers for ranking things and positions such as electronics and electric items, movies, TV shows, restaurants and hotels, Police and military [army and navy for the staffs] and other items which are directly related to environment. For example, one to five stars is commonly employed to categorize hotels and restaurants, same as in police and army department three star is given to the inspectors and in mutual fund schemes five star or seven star given to the highly liquid and safe fund .In electronics and electrical items five star rating is given to more energy saver product and one star rating is given to highly energy consumable product The star classification system is a common one for rating hotels and mutual fund schemes. In hotels higher star ratings indicate more luxury while in mutual fund it indicates best performed fund in a relating year. The star rating practices are not in use for the companies in India or in the world. But from last one decade some corporate mutual fund houses are using **Star** word for ranking of various mutual fund schemes. Now my question is that Why? , we not use this word for the rating of Indian Corporate sectors. It is the need of hour, because in fast growing and changing financial environment investors of the company cannot judge companies' actual financial and non financial performance or image on the basis of information given in the annual report. Suppose one company or companies' management having political relation with political leaders of ruling party. When political person gives unfair advantages to the company or management of the company, the performance of the company may increase and the market prices of company's share increase also but when news comes in the market about political relation with the management of company with ruling party or any political person, the market price of the company's may fall suddenly and company and its shareholders losses investment amount, like DLF, Jindal and steel power ltd. and Indian cement ltd. So we must rank to the all corporate sectors which are playing in Indian financial market and listed their shares in BSE and NSE. For this purpose I have developed a score card which can help in the corporate rating. This paper mainly discussed the importance of SPEAFP score card in star rating.*

Keywords: - Star, SPEAEP Score Card, BSE etc.

I INTRODUCTION

Investors experience significant financial losses when fraud occurs at publicly-traded companies such as Satyam Computers. Some experts suggest that the rate of fraudulent financial reporting will likely increase during the current economic recession. According to a 2006 report by the North American Securities Administrators Association, investors lose \$40 billion annually due to securities fraud (NASAA 2006). According to Glass Lewis & Co. (2005), investors lost nearly \$900 billion in market capitalization from 1997 to 2004 due to high profile frauds. Though losses to investors from fraud remain significant, research to date has not examined how and to what extent investors consider the possibility of fraud *before* making investment decisions. Specifically, there is a paucity of data regarding how investors evaluate the likelihood of financial statement fraud via fraud risk assessments or utilize "red flags" (i.e., fraud warnings signals) to avoid investing in fraudulent companies. Audit standards

require auditors to assess the risk of fraud for each audit engagement (AAS-4 or AAS-6). Prior research in fraudulent financial reporting has identified many red flags such as high accrual levels, a large number of employees on the board of directors, and unusually high equity-based compensation, under valuation of assets and liabilities , overvaluation of assets and liabilities, rate of NPA [in case banking sectors]. However, little is known regarding if and how investors perform these activities prior to making investment decisions. Despite the fact that investors are often the victims of fraudulent financial reporting, we are unaware of any prior research that investigates investors' perceptions, judgments, and actions related to financial statement fraud or performance of companies. This paper takes an important step in this area.

In this study I am suggesting a model that examines investors' reliance on financial statement information, their perception of the frequency of fraud occurrence,

the importance they place on fraud risk assessment as an investment activity, and, ultimately, their use of fraud red flags.

Impact of Political Relation on the Share Price

Company	(Value of Share Price) Before Happening event	Nature of Event Related to Companies	(Value of Share Price) After Happening Event	Group
India Cement	89	IPL Fixing	61	Srinivasan and his son-in-law
DLF	242	Land Scam with Raburt Badera	103	K. P. Singh
Reliance Comm.	420	2G Spectrum	35	Anil Ambani
Reliance Capital	980	2G Spectrum	280	Anil Ambani
Jindal Steel and Power Ltd.	288	Coal Scam	128	Navin Jindal

Impact of No Corporate Governance and Lower Financial Performance on the Share Price

Company	Sector	High Price (Rs.)	Low Price (As on 20/11/14) (Rs.)
Jai Prakash Associate	Cement	89	32.15
J.P. Power	Power	48	14
Unitech Ltd.	Construction	122	19
GVK Power and Infra	Power and Infra	20	7
Kingfisher Airlines	Airline	152	1.60
Alok Industries	Cloath	42	8

Mostly some investor invests their amount in share or bonds on the basis of financial information available in the annual report of the company. The financial information disclosed in the annual report can be fake or unreliable. If financial information are true or fair, but users of such information are not aware or have not sufficient knowledge about the technical terms of the annual report, and he/she makes an investment in share of the company, there are more chances to loss of money. But if we grant star rating to all Indian companies, [which are listed in National Stock Exchange /Bombay Stock Exchange] on the basis of their financial and non-financial performance, and an investor made his/ her investment in any type of share on the basis of star rating, I can say that he/she will not lose principle amount.

For protecting interest of the investors we must rank to the all companies, which shares are trading in stock market. For this purpose **SPEAFP SCORE CARD** has been developed and suggested it for the implementation.

II SOCIAL, POLITICAL, ECONOMICAL AND FINANCIAL PERFORMANCE SCORE CARD [SPEAFP SCORE CARD]

(a) Features

SPEAFP SCORE CARD is an original, unique and new method and concept of star rating for corporate sectors. This model has been developed and designed by Author of the paper. Such type of method of star rating for corporate sectors [except hotels and restaurants] neither using in India nor anywhere of the world. The model comprises the following features-

S= SOCIAL

P= POLITICAL

E= ECONOMICAL, AND

F=FINANCIAL

P=PERFORMANCE, SCORE CARD

This model focused on the following key areas-

K= Knowledge or familiarity gained by experience or research.

O= Observation

L=Lucrative [It means profitable]

I= Investment [expending money]

This Model is a layout of investment designed by knowledge, experience, observation and research for expanding money of investors and organization in the form of star rating for safety, security and wealth and profit maximization.

(b) Action of model

The model is a Comprehensive exercise that considers various critical parameters for star rating of corporate sector. This methodology has been developed from an investor's perspective. If star rating will be accepted widely among investors, corporate houses, stock exchange, legal authorities and Independent financial analysts and adviser. This model will be suitable for that investor who buys shares of the Company from primary market (IPO) or secondary market for the point of investment. Because he/ she have/has not any sufficient knowledge about the company. This model will be helpful in providing an indication to the investor for investment.

(c) Basic Eligibility

Following can be basic requirement for star rating

- as on 31st march (of the rating year) from The company must have completed five year the date of business commencement (in case public company) or date of incorporation (in case of private company)
- The company must have name in the list of NSE or BSE
- The company must be an Indian Company.

{Rating year- The year in which company's performance are rated.}

{Rating date- The date of rating of the rating year}

(d) Parameters

One of the unique features of SPEAFP SCORE CARD is the dynamic classification of parameters, which is based on the security listed in the stock exchange, EPS, PAT, rate of dividend, sales, NPA level, and level of risk and solvency position of the companies over the rating periods of five year, and objective and vision stated in their profile. This kind of approach of investment based on companies' classification stands

more relevance as assets allocation and investment pattern determines the risk level associated with the nature of the company and also serves as an indicator of the refinances of the management. The main outcome is that these parameters rating reflect companies financial pictures and their performance .The rating done on the basis of above factors serving as an effective guide to the users (Mainly investors) ,after analysis the ranks assigned to the companies. This analysis consider the certain critical parameter including-

- Listing in BSE/NSE
- EPS
- Book value and market value
- Long term solvency and Short term solvency
- Profitability and liquidity position
- Corpus size
- Credit Quality
- Corporate governance and CSR
- Risk Management
- Good Track Seconds
- Corporate Image
- Corporate governance and ethics [including code of law]

III METHODOLOGY

The corporate sector can be rated using the methodology of the SPEAFP SCORE CARD or Model. Certified star rating can be provided to various companies (involving in financing, processing, mining, manufacturing, transportation and trading activities). The rating parameter can be designed by any certified agency. The parameter can be qualitative and quantitative.

This model has been divided into 30 activities. And each activity having some weight in the score form. When a company fulfills condition of pertaining activity, the score is given to the company for that activity. The total score of this card are 400. If the totals score of rating company is more than 380, the company rated by Diamond star.

This model is based on the following parameters [Total Marks= 400]

S.N.	Parameters	Marks allotted
1	The company having name in the following any one or both major indices : S&P CNX Nifty and Sensex	10
2	The company having name in any one of the following sectorial indices like - CNX Auto Index, CNX FMCG Index, CNX Bank index, CNX IT Sector Index, Bankex, Bank Nifty, BSE Healthcare, BSE Metal, BSE Oil and Gas, BSE Capital Goods, BSE PSU, BSE Tech, BSE Small and Midcap, CNX Midcap,	8
3	The company is not listed in Nifty/ Sensex / sectorial indices of CNX and BSE but having name in the list of group A of BSE	6
4	If company having name in the group B of BSE	4
5	If company have not registered in the group A and B of BSE but having name in the other group of BSE	2

6	The company having Market capital more than Rs 100000 crore [as on rating date]	10
7	The company having Market Capital more than Rs.50000 crore but less than Rs 100000 crore [as on rating date]	8
8	The company having Market Capital more than of Rs.20000 crore but less than Rs. 50000 crore [as on rating date]	6
9	The company having market capital more than of Rs.5000 crore butt less than Rs.20000 crore [as on rating date]	5
10	The company having market capital less than 5000 crore [as on rating date]	4
11	Company having branch outside of India	2
12	Company is a holding company and having one or more subsidiary company in India or out side of India	2 marks for each subsidiary company [Maximum 4]
13	Company is a subsidiary company	1 marks
14	If company having ADR / GDR / UDR / in its share capital portion	1 marks
15	Liquidity position (short term solvency position) I Liquid ratio- (a) If liquid ratio / quick ratio is 1 (b) If liquid ratio / quick ratio is more than 1 (c) If liquid ratio is less than 1 II Current ratio - (a) If Current ratio is 2 (an ideal ratio) (b) If Current ratio is lying between 2 and 1 (c) If Current ratio is more than 2 III Cash ratio - (a) If it is 1 (b) If it is less than 1 (c) If it is more than 1	8 4 2 5 2 1 3 2 1
16	Financial position of the company[long term solvency position] I Fixed assets ratio- (a) If fixed assets ratio is an ideal ratio (it means if it is 0.67) (b) If fixed assets ratio is less than 1 (c) If fixed assets ratio is more than 1 II Debt equity ratio- (a) If it is an ideal ratio (it means if it is 1) (b) If it is less than 1 (c) If it is more than 1	2 1 0 3 2 1

17	<p>Profitability status of the company</p> <p>I. Overall profitability ratio (ROI) -</p> <p>(a) If it is less than 10% (b) If it is less than 30% but more than 10% (c) If it is less than 50% but more than 30% (d) If it is more than 50%</p> <p>II. Return on Equity shareholder funds ratio-</p> <p>(a) If it is Zero or negative (b) If it is less than 25% (c) If it is less than 50% but more than 25% (d) If it is more than 50%</p> <p>III. Net profit ratio:</p> <p>(a) If it is Zero or negative (b) If it is less than 25% (c) If it is less than 50% but more than 25% (d) If it is less than 100% but more than 50% (e) If it is more than 100%</p> <p>IV. Operating ratio:</p> <p>(a) If it is less than 30% (b) If it is less than 50% but more than 30% (c) If it is less than 80% but more than 50% (d) If it is more than 80%</p>	<p>1 2 3 5</p> <p>Zero 2 3 5</p> <p>Zero 2 3 5 7</p> <p>5 3 2 1</p>
18	<p>Market strength</p> <p>I- EPS-</p> <p>(a) If EPS is negative (b) If EPS is less than 25 times (c) If EPS is less than 50 times but more than 25 times (d) If EPS is less than 75 times but more than 50 times (e) If EPS is less than 100 times but more than 75 times (f) If EPS is more than 100 times</p> <p>II-Price Earnings ratio (PER)-</p> <p>(a) If PER is less than 1 times (chances of undervaluation of share) (b) If PER is less than 3 times but more than 1 times (c) If PER is less than 5 times but more than 3 times (Ideal ratio) (d) If PER is more than 5 times (chance of over valuation of share)</p> <p>III-Dividend Per Share-</p> <p>(a)No dividend declared or given in the privies year (b) If DPS is less than 0.1 (c) If DPS is less than Rs.10 but more than Rs. 0.1 (d) If DPS is less than Rs. 50 but more than Rs.10 (e) If DPS is less than Rs. 100 but more than Rs.50 (f) If DPS is more than Rs. 100</p> <p>IV-Payout Ratio-</p> <p>(a) If it is less Rs.25% (b) If it is less than 50% but more than 25% (c) If it is less than 75% but more than 50% (d) If it is less than 100% but more than 75% (e) If it is more than 100%</p> <p>V-Net Assets value per share (It is also known as book value per share)</p> <p>(a) If NAV is less than market price of share (as on 31st March of the rating year) (b) If NAV is more than market price of shares (c) If NAV is equal to market price of share</p>	<p>Zero marks 4 6 10 15 20</p> <p>1 2 5 3</p> <p>4 6 8 10 2 Zero</p> <p>1 2 3 4 5</p> <p>10 8 4</p>

19	<p>Ethics, Governance and Accounting</p> <p>I-Corporate Governance -</p> <p>(a) If report of corporate governance is good 3</p> <p>(b) If report of corporate governance is Satisfactory 2</p> <p>(c) If report of corporate governance is unsatisfactory Zero</p> <p>II- Audit Team -</p> <p>(a) If report is Satisfactory 3</p> <p>(b) If report is Satisfactory but remarkable 2</p> <p>(c) If report is unsatisfactory Zero</p> <p>III-Accounting-</p> <p>(a) If financial statements has been prepared as per rule. 3</p> <p>(b) If full disclosure related to accounting issue is given in the annual report. 2</p> <p>(c) If Company highlight at least 5 year financial data (related to, profit, divided, EPS, DPS, Operating ratio, sales, capital, employed, cash, ratio and current ratio) in annual report. 2</p> <p>IV-Business Ethics -</p> <p>(a) If Company follows all codes of business ethics 2</p> <p>(b) If Company's top management are not involved in any unethical transaction or issue of fraud. 3</p> <p>(c) If Company's top management are involved in any unethical transaction or issues of fraud, but claims are pending in the court. 2</p> <p>(d) If Company's top management has been held guilty or liable for any type of misconduct or fraud or unethical issues. 1</p> <p>Zero</p>	
20	<p>Corporate Social Responsibility</p> <p>(a) If Company providing any type of social Contribution 3</p> <p>(b) If Company is not providing any type of social Contribution but there is no social cost from the side of Company. 2</p> <p>(c) If Company providing some social benefits to the society, but it Creating any type of social cost. 1</p> <p>(d) If Company Creating any type of social cost Zero</p>	
21	<p>Cost Management</p> <p>(a) For effective internal control system. 3</p> <p>(b) For effective information system. 2</p>	
22	<p>Environmental Issues and Management</p> <p>(a) For energy saving and management 3</p> <p>(b) For any type pollution control. 3</p> <p>(c) For Waste management 3</p> <p>(d) For recycling 3</p> <p>(e) For Greenery/eco-friendly product. 3</p>	
23	<p>Achievement and Awards (In any last five year)</p> <p>(a) If Company is/was a Maharatan Company 5</p> <p>(b) If Company is/was a Navratan Company 3</p> <p>(c) If Company is/was a Mini Navratan Company 2</p> <p>(d) If Company have/had won any type of award/prize at International level 3</p> <p>(e) If Company have/had won any type of award/prize at National level 2</p> <p>(f) If Company having name in list of is the Global fortune-500/ forbs magazine. 5</p>	
24	<p>Corporate image</p> <p>(a) If the owner /CEO of the corporate houses of the respective company is one of the top 10 richest person of the world 3</p> <p>(b) If the corporate houses of the concerned company is one of the top 10 richest person of the India 2</p>	

25	If the company having name in the list of top 10 ranked companies- (a) If it is ranked by any national news agency or any other ranking agency (b) If it is ranked by any local agency	3 2
26	Salary package of CEO / MD / Chairman of the company (a) If annual salary is less than Rs. 1 crore (b) If annual salary is less than Rs. 5 crore but more than 1 crore (c) If annual salary is less than Rs.10 crore but more than 5 crore (d) If annual salary is less than Rs.20 crore but more than 10 crore (e) If annual salary is more than Rs.20 crore	5 4 3 2 1
27	Political link (a) If a corporate house is leading by any political leader (b) If a corporate house is not leading by any political person.	2 3
28	For Product or service innovation	5
29	Merger and acquisition (a) If company is (going to become) a transferee company in a merger /acquisition. (b) If company is is (going to become) a transferor company in a merger acquisition	3 2
30	If company having a corporate ombudsman.	5

Notes

- (a) Debt equity ratio means = $\frac{\text{Long term debts}}{\text{Shareholders fund}}$
- (b) Overall profitability ratio means = $\frac{\text{Operating profit}}{\text{Capital employed}} \times 100$
- (c) Price earnings ratio means = $\frac{\text{Market price per equity share}}{\text{EPS}}$
- (d) The dividend per share can be net or gross. In this model I have considered net dividend per share method = $\frac{\text{Ordinary dividend paid to ordinary shareholders}}{\text{No. of ordinary shares}}$
- (e) Net assets value per share means = $\frac{\text{equity share capital} + \text{revenue} - \text{intangible assets}}{\text{No. of equity share outstanding at balance sheet date}}$

Rating scale for corporate sector

Rank	Scale (minimum scores)	Interpretation
Diamond star	Company with composite score above 380	Highly profitable, effective management, sound financial position (long term) and good corporate image.
7 star	Company with composite score lying between 380 to 360	Highly profitable, sound financial position, more liquid , responsible towards society and strong financial and managerial policy.
5star	Company with composite score lying between 360 to 320	More stable company, strong fundamentals, more liquid and profitable
4 star	Company with composite score lying between 320 to 280	Effective and valuable management, stable financial structure, fast emerging business and optimum use of fund
3 star	Company with composite score lying between 280 to 240	Better liquidity, Best cost management system, good corporate image, good fundamental capital structure.
2 star	Company with composite score lying between 240 to 200	Good financial structure, average financial planning and policy, undervalued or highly overvalued firm,
1 star	Company with composite score lying between 200 to 160	Risky but growing management
Red single	The company which is not ranked / rated or having scored less than 160.	More risky



Indication for the Investors

Types of Stars	Liquidity	Level of Risk	Profitability	Remark
	More	less	High	Good for Investment
	More	less	High	Good for Investment
	More	less	High	Good for Investment
	More	less	high	Good for Investment
	More	less	Good	Good for Investment
	Average	Average	Good	Good for Investment
	Average	Average	Average	Good for Investment
	Low	Very high	Very low	No

Note- 5 star and 4 star rated companies are suitable for intraday trading also.

Indication for the Investors

	Strongly buy the shares of Diamond star rated Company and invest more than 5 years
	Strongly buy the shares of Seven star rated Company and invest for long term at least 5 years
	Strongly buy the shares of Five star rated Company and invest for long term at least 3 years
	Average buy the shares of Four star rated Company and invest for short term at least one years
	Average buy the shares of Three star rated Company and invest for short term at least six months
	Buy the shares of Two star rated Company and invest for short term at least Three months

	Buy the shares of One star rated Company and invest for one month
	Aviod

IV ADVANTAGE OF THE SPEAFP SCORE CARD

This model mainly has been developed and designed for the benefits of the investor who is going to purchase a share of the company from the stock market [BSE or NSE]. Beside this the **SPEAFP SCORE CARD** will provide a valuable and effective indication to the investor for making a healthy investment in the share market.

Following are some of the advantage of the model-

- (a) It provides data for inter firm comparison.
- (b) It helps in financial planning and forecasting.
- (c) It provides an indication for the short term and long term solvency of the company.
- (d) It helps in understanding the past trend in respect of dividend, profit and liquidity.
- (e) The higher star rating indicates a good investment opportunities

V RECOMMENDATIONS

- (a) It must be made mandatory for all Indian Companies whose shares are exercising in any stock exchange.
- (b) Star rating must be done after every five year

VI CONCLUSION

In this paper, I have designed a model known as SPEAFP Score Card. This model is based on social, political, economical and financial issues which may affect overall performance of the company and its market price of a share. By using this model an organization can be rated with five or one star. And an investor can invest their money in the share of well star rated company and can make safe and secure investment. So, it is a need of the hours to implement star rating practices for the company for their all over performance.

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