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Financial analysis by return on equity (ROE) and return on asset (ROA)-A comparative study of HUL and ITC

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ABSTRACT

The financial performance of the top two companies of the FMCG sector HUL and ITC are analyzed in this research paper by using the two most popular financial tools of analysis i.e., ROE and ROA. Similar to the DuPont method, components of Return on Equity (ROE) and Return on Asset (ROA) are segregated to do the analysis of financial performance and to accomplish the objective. To calculate ROE and ROA, ratios such as net profit ratio (NPR), total asset turnover ratio (TATR), and equity multiplier (EQM) will be used. It is observed that the use of financial leverage was mainly responsible for the whole decrease in return on equity (ROE). In terms of return on equity, we found that the Asset Turnover Ratio increases somewhat, while in the case of ITC, the ratio either remains the same or slightly decreases in value. As a result, HUL's total asset turnover ratio (TATR) is greater than that of ITC, suggesting that HUL is more efficient in its asset use. We were able to demonstrate statistically, via the use of the One-way Anova test, that there is a significant meaningful association among the ratios.

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1. Introduction

Companies do look at their financial health via the use of gross margin, net margin, ROA, and ROE. The information helps one to judge the firm's overall condition since it shows how a company performs in comparison to other businesses. Even though these numbers are not very useful on their own, they may be used to measure oneself against others in the industry or to see how much one has improved over time. A company's financial future may be determined using these kinds of research.¹ It is a common occurrence for shareholders to be more interested in this information than business executives. The advisors will first assess the two of them to see whether they are even eligible to get engaged. It shows whether or not the company is worthwhile to invest in. The banks will also take into account all of these details when determining whether or not to provide business

money. In some industries, managers may rely on the return on assets when making decisions. It's a useful statistic for determining the return on investment in manufacturing and other industrial companies, so they may assess their efficiency. Often when a company in the infrastructure sector has a big profit margin, it will discover that its ROA is even higher. If you discover how to do this with fewer assets, you may be able to increase your profit margin. But the authority of the management team extends to corporate shares and debt, and their primary priority is profitability. Calculations will be performed by the DuPont method after breaking down the fundamental ROE and ROA formulae into their various components.

1.1. Return on equity (ROE)

ROE indicates how much profit may be made for every rupee invested in a business. In every sector, this is a crucial ratio, and for certain firms, it's more important than ROA.

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For example, banks often bolster their capital by taking in as many deposits as possible before making loans with a higher interest rate. Their return on assets (ROA) is almost non-existent, therefore they aren't doing very well at generating money. However, present in all organizations, but it may vary in terms of equity for each business.

The following formula is used to calculate the return on equity (ROE):

$$ROE = \frac{NET\ PROFIT}{TOTAL\ SHARE\ HOLDER'S\ FUND}$$

Equation: 1-A (Basic formula of ROE)

Calculation of Return on Equity (ROE) will be into three components: operating efficiency, asset efficiency, and leverage. Net Profit Margin is a metric of operational efficiency that indicates how much net income is made per rupee of revenue generated by a business. The Total Asset Turnover Ratio (TATR) is a financial indicator of asset efficiency that indicates the amount of money generated per rupee invested in assets. Finally, the Equity Multiplier is in charge of financial leverage calculation.

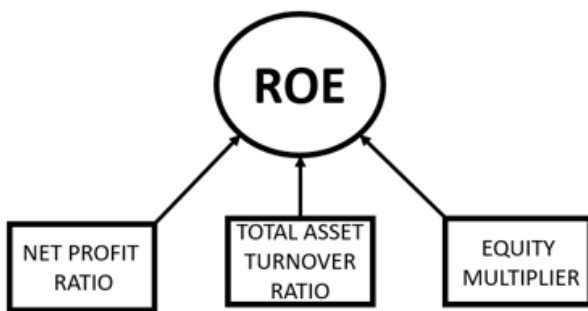


Fig. 1: (Breaking down ROE into three components)

The following is the equation of ROE after breaking down into three factors:

$$ROE = NPR \times TATR \times EQM$$

Equation: 1-B (Basic formula for ROE after breaking down into components)

Where, NPR= net profit ratio, TATR= total turnover ratio, and EQM=equity multiplier

We may alternatively express the components as a set of ratios, as follows:

$$ROE = \frac{NET\ PROFIT}{TOTAL\ ASSET} \times \frac{SALES}{TOTAL\ ASSET} \times \frac{TOTAL\ ASSET}{EQUITY}$$

Equation: 1-C (Formula of ROE in three-component)

An organization's output rises as these factors rise. Net Profit Margin and Total Asset Turnover are also subject to a give-and-take within different industries. The last component, financial leverage, deals with the company's financial dealings. The more the company's debt, the higher

the chance of default. Even when there is no danger, more debt lowers the return on equity. Increased interest expenses lead to lower net income. This causes the company's net profit margin to decrease.

1.2. Return on asset (ROA)

Return on asset (ROA) is an investment return of sorts, and it may be defined broadly (ROI). It gives us information about the amount of money returned to you in return for every rupee invested in the business. ROA demonstrates the capacity of your business to produce profits utilizing its assets. In some sectors, ROA is greater than others because the amount of capital invested in assets varies. Businesses that make products will frequently shell out big money for infrastructure and equipment. It may be essential for a service company to acquire costly IT technology. Stores need to have a large supply of merchandise. No matter what kind of company you have, it gives us a view of the whole picture.

The company's operational efficiency is affected by the use of resources, which is seen in the net profit margin. Success and failure are not necessarily tied to high and low-profit margins. A business may have low margins yet still be successful if it is creating a high return on its investments and assets. The two factors used to calculate a company's total operational efficiency are combined. Asset turnover calculates how well an organization utilizes its assets, while net profit margin evaluates how profitable the company's sales are. The following figure indicates the basic integrated analysis of ROA.

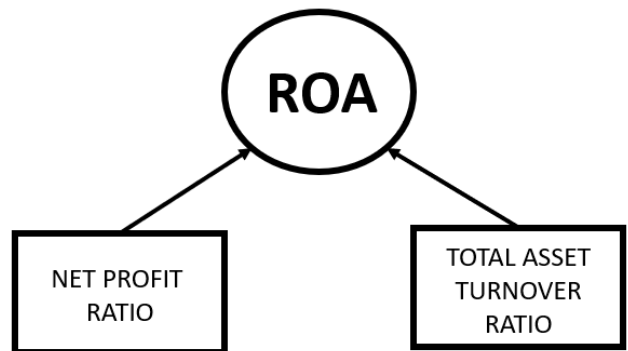


Fig. 2: (Breaking down ROA into two components)

The following equation is of ROA after breaking down into two factors:

$$ROA = NPR \times TATR$$

Equation: 2-A ((Basic formula for ROA after breaking down in components)

Where, NPR= net profit ratio, TATR= total turnover ratio

We may alternatively express the components as a set of ratios, as follows:

$$ROE = \frac{NET\ PROFIT}{SALES} \times \frac{SALES}{TOTAL\ ASSET}$$

Equation: 1-C (Formula of ROA in two-component)

The Return on Assets Ratio (ROA) is a useful measure for measuring the total profitability and operational efficiency of a business since it demonstrates how profitability and operational activity interact. This concept posits that raising the return on investment, or return on capital, either by expanding sales volume or improving profit margin, would improve the firm's performance.

2. Literature Review

S. Christina Sheela and Dr. Karthikeyan (2012) evaluated the pharmaceutical industry's financial performance from 2003 to 2012, concentrating on three main players: Cipla,¹ Dr. Reddy's Laboratories, and Ranbaxy Pharmaceuticals. The author used DuPont analysis to ascertain the company's earning potential (ROI and ROE). According to the author, it is a critical tool for assessing an organization's financial performance. The author concluded that the DuPont research (which calculated ROI and ROE for India's top three pharmaceutical companies) showed that absolute metrics are not always appropriate in all circumstances. As a consequence, it is essential to create a consistent basis of comparison for various companies when computing the ratio, as well as to build rankings of relative sizes to assess efficiency.

Citra Shahnia and Endri (2020) examined the financial performance of seven companies listed on the Jakarta Stock Exchange from 2014 to 2018. The author utilizes DuPont analysis to evaluate a company's operational performance using return on equity and return on assets. Various financial measures are used in this study to evaluate the degree of a business's success in managing corporate assets from sales-generated earnings. Author's findings: Let us start with financial ratios for trading. Assuring current debt repayment is measured by the liquidity ratio. Financial health and capacity to meet immediate and long-term obligations are known. Based on the author's study during 2014-2018, these companies' liquidity ratios were over 1. The activity ratio examines the link between sales and needed assets. Most valuable in 2014-2018 was PT Alakasa Industrindo Tbk. The proportion of activity is related to sales volume. The greater the ratio, the better. ABM Investama Tbk and Global Mediacom Tbk provide higher returns to shareholders than Bakrie and Brothers, Polaris Investama Tbk, and Saratoga Sedaya Tbk.

Kim (2016)² assessed the financial well-being of a food distribution company in light of its number of sales. The author analyzed ROE and ROA using the DuPont framework to reach the goal, and the results have been presented in tables that show how these ratios have changed over time. According to the results of the study, Hyundai Green Food leads the financial performance of all four

of the listed food brands, followed by Food Merce and then Dongwon Home Food and Lotte Food. These four companies are big names in their industries. The author found that the best ways to gauge the profitability of a business are the return on equity and the return on investment. It accounts for the choices that people may make about running, investing, finance, and leveraging.

Fitri Sukmawati and Innes Garsela (2016)³ investigated the relationship between the return on assets and the return on equity of a company's stock price. In this research, the author used descriptive-quantitative analysis, which included the application of the classical assumption test. Multiple linear regression analysis, multiple correlation analysis, determination, the t-test, and the f test are some of the statistical techniques used by the author. The author's results show that variances can explain the stock price by demonstrating that as the return on equity rises, the stock price declines. Variations The ratios of the return on assets and return on equity can explain the variance in share prices when considered together.

Bhagya Lakshmi (2019)⁴ conducted research in which DuPont analysis was used to evaluate the performance of selected automobile companies, assessed by ROCE (ROE). The study was designed to assess the performance of a company and the value it produces relative to total assets, sales, and other key variables. A team of researchers from IIM, Bangalore, conducted their study on 10 automotive companies listed on the National Stock Exchange (NSE), from 2013 to 2017. The author states that the correlation and regression analysis is performed to identify if a relationship exists between the aforementioned variables and to determine the ROE and EM effects. As the author discovered, all of the variables except EM were linked together, and selected companies had significantly different financial performances when compared on return on equity and return on assets.

2.1. Need of research

After examining several research papers on ROE and ROA, we found that none of them included critical information regarding ROE and ROA. Additionally, none of the publications included instructions on how to do a ROA analysis.⁵ Due to the absence of a comprehensive financial analysis of the FMCG sector in India, we selected two companies from the NIFTY FMCG index to undertake our research: HUL and ITC. Our study addressed in detail ROA and ROE, as well as how to analyze them by breaking them down into components. Additionally, this article discusses several components, including the Total Asset Turnover Ratio (TATR), the Net Profit Ratio (NPR), and the Equity Multiplier (EQM). The aim of breaking into components is to identify associations between them as well as the long-term effects of all of these components on ROE and ROA. The purpose of this study is to analyze the financial

performance of selected companies such as HUL and ITC, to determine their profitability using ROE and ROA, and to determine the effect of the Net Profit Ratio (NPR), the Total Asset Turnover Ratio (TATR), and the Equity Multiplier (EQM) on ROE and ROA. Essentially, this tutorial will explain to investors how to do a fundamental analysis of a business's profitability.

3. Research Methodology

We selected two FMCG companies from the NIFTY FMCG index to examine as part of our research, namely HUL and ITC. Between 2010 and 2021, a total of twelve years of data will be collected. Secondary data was gathered from annual reports and the moneycontrol.com website. Excel was used to gather all of the data and do all of the mathematical computations. To determine if there was an association between NPR, TATR, and EQM into excel, an ANOVA test was performed. This test aimed to determine whether or not two groups are associated based on the assumption of two hypotheses. The P-value is used to determine the validity of the hypotheses. If the P-value is less than the usual significance threshold of 0.05, the null hypothesis is rejected and alternative hypotheses are considered. The null hypothesis says that no connection exists between the two groups selected for the test, while the alternative hypothesis argues that an association exists between the two groups selected for the test.

4. Scope of Research

This research examines the financial performance of two large-scale FMCG companies, ITC and HUL. This research study has assessed the ratios of ROE and ROA, breaking them down into their and two components by using the DuPont technique, and demonstrating them with tables that illustrate how they have changed over time. To review ROE and ROA, we analyzed the elements by breaking them down. This included evaluating NPR, TATR, and EQM. The three components of return on equity: net profit margin, total asset turnover, and equity multiplier, and the two components of return on asset: net profit margin and total asset turnover.⁶ This research focuses on the comparison ratio.

5. Data and Analysis

In this section, the financial data of HUL and ITC is given in Table 1 and Table 2 respectively and data of one-way Anova test is also given in this section.

Were, NPR= Net Profit Ratio

1. TATR= Total Asset Turnover Ratio
2. EQM= Equity Multiplier
3. ROA= Return on Asset
4. ROE= Return on Equity

Table 1: (Collected and calculated data of HUL)

Year	Sales	Net Profit	NPR (%)	Total Assets	TATR (%)	Share Holders fund	EQM (%)	ROA (%)	ROE (%)
2010	17738	2157	12.16	9506	186.60	2583.52	367.95	22.69	83.49
2011	20023	2296	11.47	10348	193.50	2659.52	389.09	22.19	86.33
2012	23436	2791	11.91	11407	205.45	3512.93	324.71	24.47	79.45
2013	27004	3829	14.18	12092	223.32	2674.02	452.20	31.67	143.19
2014	29234	3946	13.50	13754	212.55	3277.05	419.71	28.69	120.41
2015	31972	4363	13.65	14430	221.57	3724.78	387.41	30.24	117.13
2016	32186	4151	12.90	14793	217.58	6279	235.59	28.06	66.11
2017	33162	4476	13.50	15706	211.14	6490	242.00	28.50	68.97
2018	35545	5214	14.67	17862	199.00	7075	252.47	29.19	73.70
2019	39310	6054	15.40	18629	211.02	7659	243.23	32.50	79.04
2020	39783	6748	16.96	20153	197.40	8031	250.94	33.48	84.02
2021	47028	7995	17.00	68740	68.41	47434	144.92	11.63	16.85

Table 2: (Collected and calculated data of ITC)

Year	Sales	Net Profit	NPR (%)	Total Assets	TATR (%)	Share Holders Fund	EQM (%)	ROA (%)	ROE (%)
2010	19127	4168	21.79	23817	80.31	14064.38	169.34	17.50	29.64
2011	22566	5018	22.24	26391	85.51	15953.27	165.43	19.01	31.45
2012	26516	6258	23.60	30085	88.14	18791.89	160.10	20.80	33.30
2013	31618	7608	24.06	35329	89.50	22287.85	158.51	21.53	34.14
2014	35306	8891	25.18	40848	86.43	26262.02	155.54	21.77	33.85
2015	38817	9663	24.89	45952	84.47	30735.69	149.51	21.03	31.44
2016	39192	9344	23.84	51651	75.88	32929	156.86	18.09	28.38
2017	42768	10289	24.06	55898	76.51	45340.96	123.28	18.41	22.69
2018	43449	11271	25.94	64241	67.63	51400.07	124.98	17.54	21.93
2019	48340	12592	26.05	71739	67.38	57949.79	123.80	17.55	21.73
2020	49388	15306	30.99	77311	63.88	64029.16	120.74	19.80	23.90
2021	49257	13161	26.72	73761	66.78	59004.58	125.01	17.84	22.31

Table 3: (Data summary of anova test for NPR_ITC and TATR_ITC)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
NPR_ITC	12	24.9467	2.4089	0.6954	
TATR_ITC	12	77.7017	9.3467	2.6982	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	16698.5402	16698.5402	358.4778	0
Within Groups	22	1024.7996	46.5818		
Total:	23	17723.3398			

Table 4: (Data summary of anova test for NPR_ITC and EQM_ITC)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
NPR_ITC	12	24.9467	2.4089	0.6954	
EQM_ITC	12	144.425	19.066	5.5039	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	85650.385	85650.385	463.8336	0
Within Groups	22	4062.4667	184.6576		
Total:	23	89712.8517			

Table 5: (Data summary of anova test for EQM_ITC and TATR_ITC)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
EQM_ITC	12	144.425	19.066	5.5039	
TATR_ITC	12	77.7017	9.3467	2.6982	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	26711.9926	26711.9926	118.4901	0
Within Groups	22	4959.6047	225.4366		
Total:	23	31671.5973			

Table 6: (Data summary of anova test for npr_HUL and TATR_HUL)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
NPR_HUL	12	13.9417	1.8128	0.5233	
TATR_HUL	12	195.6283	41.6337	12.0186	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	198060.1237	198060.1237	228.0943	0
Within Groups	22	19103.1634	868.3256		
Total:	23	217163.2871			

Table 7: (Data summary of anova test for npr_HUL and EQM_HUL)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
NPR_HUL	12	13.9417	1.8128	0.5233	
EQM_HUL	12	309.185	93.779	27.0717	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	523011.6372	523011.6372	118.8962	0
Within Groups	22	96775.6579	4398.8935		
Total:	23	619787.2951			

Table 8: (Data summary of anova test for tatr_hul and eqm_hul)

Data Summary					
Groups	N	Mean	Std. Dev.	Std. Error	
TATR_HUL	12	195.6283	41.6337	12.0186	
EQM_HUL	12	309.185	93.779	27.0717	
ANOVA Summary					
Source	Degrees of FreedomDF	Sum of SquaresSS	Mean SquareMS	F-Stat	P-Value
Between Groups	1	77370.7447	77370.7447	14.6983	0.0009
Within Groups	22	115806.524	5263.9329		
Total:	23	193177.2687			

Table 9: (Data summary of f-statistical value and p-value of all group)

Groups	F-Statistical Value	P-Value
NPR_ITC AND TATR_ITC	358.47778	0
NPR_ITC AND EQM_ITC	463.83358	0
EQM_ITC AND TATR_ITC	118.49005	0
NPR_HUL AND TATR_HUL	228.0943	0
NPR_HUL AND EQM_HUL	118.89618	0
TATR_HUL AND EQM_HUL	14.69828	0.0009

6. Findings

Finally, we have examined the results of the model and data gathered for ITC and HUL in this part. Net profit is the basis used to assess the effectiveness of an organization's operations. The asset turnover ratio is a measure of the efficiency with which assets are used. The equity multiplier is a measure of the amount of leverage used. Examining the performance of HUL and ITC in respect to the parameters mentioned above, we may determine who is lagging behind the rest of the field.

1. **Net Profit Margin:** Throughout the period 2010-2021, HUL's net profit margin remained steady, with the bulk of it falling between 13 % and 15 % on an annual basis. For ITC, the net profit margin has ranged between 22 % and 24 % during the same period in question. To determine how much HUL lags behind ITC, it is obvious that Net Profit Margin is an important element to consider. By growing income, such as by selling more products or by raising pricing, HUL may improve their net profit margin, and by decreasing

expenses, they can increase their net profit margin (e.g., finding cheaper sources for raw materials).

2. **Asset Turnover Ratio:** As can be seen, HUL's Total Asset Turnover ratio has continuously been between 200 % and 220 %, while ITC's Total Asset Turnover ratio is lower and has been falling from 80 to 65 % since inception, suggesting that assets are not being effectively used. ITC lags in this regard. Asset turnover ratios may be improved by properly stocking shops with marketable products, restocking inventory only when necessary, and extending operating hours to maximize customer foot traffic and income.
3. **Financial leverage:** It is measured by the equity multiplier. For the period 2011-2021, HUL has an equity multiplier in the region of 250 % to 300 %, while ITC has an equity multiplier in the range of 120 % to 150 %. This indicates that HUL is highly indebted.⁷ The example of HUL also demonstrates that the company has made extensive use of leverage in the years 2013 and 2014, with an increase of about 400 %.

When we look at HUL more closely, we can see that the whole change in return on equity was due to the increased use of financial leverage.⁵ Furthermore, we find that when ROE rises, the Asset Turnover Ratio rises somewhat, but in the case of ITC, it almost stays the same or falls little. HUL outperforms ITC in terms of return on assets ROA because HUL's TATR is higher than ITC's, which essentially indicates that HUL is making greater use of its assets.⁸

Using the One-way Anova test, we discovered an association between all of the variables that are responsible for the change in the company's return on equity and return on assets. All the related data for the test are given in the Table 3 to Table 9.

$\mu_0 =$ there is no association between two groups.

$\mu_1 =$ there is association between two groups.

Where μ_1 is the alternative hypothesis that we can accept when the μ_0 is rejected.

The null hypothesis will be rejected if the p-value is less than the usual significant threshold of 0.05, and the alternative hypothesis will be taken into account. Below are the results of the test;

1. The one-way ANOVA test of independence showed that there was a significant association between NPR and TATR of ITC, $p < 0.05$.
2. The one-way ANOVA test of independence showed that there was a significant association between NPR and EQM of ITC, $p < 0.05$.

3. The one-way ANOVA test of independence showed that there was a significant association between TATR and EQM of ITC, $p < 0.05$.
4. The one-way ANOVA test of independence showed that there was no significant association between NPR and TATR of HUL, $p < 0.05$.
5. The one-way ANOVA test of independence showed that there was no significant association between NPR and EQM of HUL, $p < 0.05$.
6. The one-way ANOVA test of independence showed that there was a significant association between TATR and EQM of HUL, $p < 0.05$.

The One-way ANOVA test findings seem to show that the groups are all linked together. Both the Dupont model and the integration analysis of ratios are well suited to the job of analyzing ROE and ROA.

7. Conclusion

The purpose of this study was to examine how profitability measures such as ROE and ROA may be used to assess financial performance. We used the DuPont method to break down ROE and ROA into components like NPR, TATR, and EQM and analyze them. According to the findings of the study, there is a strong relationship between three variables: NPM, TATR, and EQM, which states that a high level of management effectiveness and efficiency of an investor's money can predict a high level of profit margin, and we also found that there can be a positive or negative relationship between all of these components using statistical tests. According to our results, the Total Asset Turnover Ratio has an impact on return on equity, while the ITC ratio remains the same or slightly decreases in value. As a result, HUL's total asset turnover ratio (TATR) is greater than ITC's, indicating that HUL uses its assets more efficiently. To have a better sense of the FMCG industry's future profitability, sector analysts and investors should pay more attention to asset turnover ratio changes rather than profit margin improvements.

8. Source of Funding

None.

9. Conflict of Interest

None.

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