

# COMPARATIVE ANALYSIS

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*This research is trying to answer the most frequent question that people ask when they are about to start a new business or they manage an already existing one "What should I do and how should I do it?". For this, a comparison between two businesses will be made, which, in the research will be called business "A" and business "Z". Both A and Z are businesses from the pharmaceutical field and they registered almost the same level of earnings. The paper starts with a presentation of the businesses, it continues with a comparative analysis of the financial statements and then it ends with the answer to the up mentioned question.*

*Key words: A, Z, portfolio, claims, earnings.*

Many people who wish to open their own business, and not only, wonder: "What should I do?" and/or "How should I do it?". Reducing this problem to its simplest form there are two choices: either you do what the competition is doing (copy/imitation) or you do it in your own way (diversify). No matter the strategy, it all comes to the following question: "Which one will offer the possibility to maximise earnings?"

For finding an answer to these questions two joint-stock companies from the pharmaceutical industry were selected. A comparison between their patrimonial and financial statements will be made for a two year period: 2005 and 2006. The selection criteria were: the companies should be players in the same field and they should have approximately the same level of earnings.

To avoid any future conflicts the anonymity of the companies will be kept, as why, during the research they will be named company "A" and company "Z".

The main activity of both firms is the production and marketing of drugs. They have been present on the pharmaceutical market from Romania for over 45 years and they are, also, in the Top 10 Drug Producers. The capital of A is totally aboriginal and is divided in 454.897.291 shares, while Z has a foreign capital divided in 416,961,150 shares. Legal persons hold the majority of the stocks, 99% respectively 92%, while the rest are private investors. Both are listed on the Bucharest Stock Exchange, A at the first category and Z at the second. At the end of 2006 the benefits registered by the companies were as follow: 23.839.146 lei A, 23.074.860 lei Z, and the turnover of Z was higher by 64% than the one of A- 210.251.770 lei

The companies wish to offer highly accessible products to the public, and, while A is focusing on the life care of the patients, Z's mission is to improve the quality of life for them (the patients). Both have implemented a joint management system where they combined the quality and environmental management with a health and work safety program. This joint system led to major investments in the infrastructure - for a better protection of the environment, in research - for the improvement of the quality and efficiency of the products and also for cost effectiveness. At the end of the analysed period A had 1552 employees and Z 1012. A considers the human resource a real "treasure" and for this, over 27% of its employees are university graduates.

The major difference between the companies is the portfolios. Both of them offer drugs for human use, which cover over 11 fields of therapy: cardiovascular illnesses, central nervous system, the digestive system, pain killers, etc. Z has a portfolio made out of 280 drugs, presented in over 550 pharmaceutical forms. 170 sell only with prescription and the rest are available as over the counter - OTC and nutritive supplements. By the type of products Z's portfolio can be divided in: drugs, supplements, cosmetics and active pharmaceutical ingredients. A's portfolio is far more complex. It contains beside human use drugs, drugs for veterinarian use, active substances and bio fertilisers. Its offer is as follows: 120 drugs for human use presented in 5 forms, out of which 32 are OTC-s, 10 veterinarian drugs, 2 active substances and 2 bio fertilisers.

The companies are allowed to set the price only for the OTC-s, because, for the prescribed drugs the Ministry Of Health dictates it. According to a statistic report made by Cegecim, Z practices a average price per pharmaceutical unit of 1,98 lei, which is way under the average price of other producers 9,25 lei per pharmaceutical unit. OTC-s and prescribed drugs contribute to the total sales of the companies with 50% each.

The upper mentioned portfolios and prices permitted Z to obtain a market share value of 3,8% and A one of 3,21%. Both A and Z sell their products at national and international level. Their costumers are hospitals,

pharmacies and other firms for the non pharmaceutical products. A has its own distribution network while Z contracted the services of a specialised distribution company, to which it offered exclusivity.

For analysing the financial and patrimonial statements the lower mentioned economical indicators and financial ratios will be used:

1. Equilibrium Indicators;
2. Intermediary Management Indicators;
3. Assets Ratios;
4. Financing Ratios;
5. Rotation Indicators;
6. Liquidity, Solvency and Profitability Ratios.

Before the analysis, in the table at our right the values used in calculating the indicators are presented:

Companie	A		Z	
An	2005	2006	2005	2006
<b>Active imobilizate</b>	<b>85,596,263</b>	<b>106,793,221</b>	<b>150,365,119</b>	<b>87,506,914</b>
I. necorporale	520,512	936,819	234,175	697,544
I. corporale	85,068,645	105,848,204	150,031,522	86,631,170
I. financiare	7,106	8,198	99,422	178,200
<b>Active circulante</b>	<b>126,224,475</b>	<b>153,843,727</b>	<b>165,649,471</b>	<b>243,132,629</b>
Stocuri	22,225,818	18,333,107	45,572,106	38,733,685
Creanțe	98,561,469	106,840,366	109,440,268	143,661,824
Disponibilități	5,437,188	28,670,254	10,637,097	60,737,120
<b>TOTAL Active</b>	<b>211,820,738</b>	<b>260,636,948</b>	<b>316,014,590</b>	<b>330,639,543</b>
Datorii pe tr. Scurt	62,814,226	77,535,385	79,918,482	72,226,341
Datorii pe tr. Lung	1,825,211	2,547,890	11,209,196	850,268
<b>Total datorii</b>	<b>64,639,437</b>	<b>80,083,275</b>	<b>91,127,678</b>	<b>73,076,609</b>
<b>Capital propriu</b>	<b>147,181,301</b>	<b>180,553,673</b>	<b>224,886,912</b>	<b>257,562,934</b>
<b>TOTAL Pasive</b>	<b>211,820,738</b>	<b>260,636,948</b>	<b>316,014,590</b>	<b>330,639,543</b>
Cifra de afaceri	166,519,961	197,748,316	216,948,578	323,399,989

#### *Simplified balance sheet*

#### *Analysis of the balance sheet*

Both businesses are in a general equilibrium at the balance sheet level fact suggested by the permanently grooving positive net treasury – TN. This equilibrium is reaches thanks to the existence of a net working capital -FR sufficiently high to cover the excess of temporary needs- NFR. Neither A nor Z register long term threats, on the contrary, their net working capital has a constantly growing tendency, and in 2006 it doubled in the case of Z due to the selling of an important property.

Comp	A		Z	
An	2005	2006	2005	2006
SN	147,181,301	180,553,673	224,886,912	257,562,934
FR	63,410,249	76,308,342	85,730,989	170,906,288
FRP	61,585,038	73,760,452	74,521,793	170,056,020
FRS	1,825,211	2,547,890	11,209,196	850,268
NFR	57,973,061	47,638,088	75,093,892	110,169,168
TN	5,437,188	28,670,254	10,637,097	60,737,120
ΔTN		23,233,066		50,100,023

#### *Equilibrium indicators*

On short term there is an excess of needs. Although this situation can be considered normal at first sight, the loss of equilibrium is not a consequence of an investment policy in stock, but is due to an external factor that affects all the companies from the pharmaceutical industry: the overdue of the claims from the Ministry of Health. A

counteracted the overflow of temporary need by reducing the stocks and increasing the current liabilities, while Z had to struggle with the opposite situation. Its need for working capital NFR grew in 2006 by 47% not only because the growth of uncollected claims but also to the diminution of the short term liabilities (see Rotation Indicators). This short term deficit can easily be covered from the Own WC, without needing the foreign WC. This statement is valid for both analysed companies and so they reach a healthy general equilibrium.

### 1. The analysis of Earnings and Loss statement <sup>193</sup>

The value growth is due to the joint management system, which reduced the level of fixed costs by 11% and also to the investments made for increasing the outputs and the level of sales. To stimulate sales A held an intense marketing campaign to promote its new corporatist identity adopted at the end of 2005. Z's efforts focused mainly on harnessing the human resources, it hired in 2006 94 new employees, marketing being a secondary concern.

Comp	A		Z	
	2005	2006	2005	2006
MC	418,909	291,663	2,075,433	-730,563
VA	90,189,055	101,841,536	84,316,306	126,927,269
EBE	51,730,686	56,936,463	55,229,768	78,635,216
Rexpl	26,344,365	29,080,864	25,442,762	57,284,311
RBrutEx	23,724,855	30,073,560	19,723,030	39,336,545
RNetEx	19,670,651	23,839,146	16,657,599	23,074,860

#### Intermediary management indicators

Although Z's added value - VA grew 4 times more than the one of A, by 50%, both A and Z are more than capable to remunerate the participants at the exploitation activity.

Is true that the strategies adopted led to more expenses with production, but despite this A's auto financing capacity grew by 10% in 2006 and Z's by 42%. The exploitation activity concluded, in 2006, with a 21,14% growth of the profitability for A and a growth of 25.14% for Z.

From the financial activity the firms registered incomes from a favourable exchange rate, but 2006 ended with a financial gain for A and a financial loss of 17.947.766 lei for Z.

All this plus the absence of any extraordinary events led, at the end of the analysed period, to a 3 percent higher net income for A than Z.

### 2. The analysis of the assets

From the table it can be noticed the almost identical structure of the immobilizations. As it is typical for all companies oriented towards production, the majority of the immobilized assets are corporal immobilizations. Their level in 2006 was higher with 24% for A, then the previous year due to the investments made in the infrastructure. For Z they diminished with 57% as consequence to a 19 million worth sale of land and constructions.

Surprisingly, the majority of the assets are current assets. This makes the companies more flexible to the market changes. Claims are the most because 24% of them are passed the collection deadline. Nevertheless they lost ground in favour of the availabilities, which amounted with 23 millions lei in the case of A and with 50 millions in the case of Z.

Comp	A		Z	
	2005	2006	2005	2006
<b>Rai</b>	<b>0.40</b>	<b>0.41</b>	<b>0.48</b>	<b>0.26</b>
Rin	0.01	0.01	0.00	0.01
Ric	0.99	0.99	1.00	0.99
Rif	0.00	0.00	0.00	0.00
<b>Rac</b>	<b>0.60</b>	<b>0.59</b>	<b>0.52</b>	<b>0.74</b>
Rs	0.18	0.12	0.28	0.16
Rc	0.78	0.69	0.66	0.59
Rd	0.04	0.19	0.06	0.25

### *Asset ratios*

#### **3. The analysis of the capital and of the liabilities**

The capital and liabilities of company A grew at a constant rate, therefore the structure of its passives did not change. The situation of Z improved. In 2006 it became financially independent on long term.

Over 97% of the debt ratio is due to short term liabilities. At the end of 2006 Z registered the highest level of financial independence, because 93% of the long term liabilities and 10% of the current liabilities were paid.

In conclusion is not wrong to say that both A and Z decided to finance their needs mostly from their own resources.

Comp	A		Z	
An	2005	2006	2005	2006
Sf	1.74	1.71	1.57	2.95
Scp	<b>0.69</b>	<b>0.69</b>	<b>0.71</b>	<b>0.78</b>
Skp	0.70	0.70	0.75	0.78
Af	0.99	0.99	0.95	1.00
If	0.01	0.01	0.05	0.00
GI	<b>0.31</b>	<b>0.31</b>	<b>0.29</b>	<b>0.22</b>
Pdts	0.97	0.97	0.88	0.99
Pdrl	0.03	0.03	0.12	0.01

### *Financing ratios*

#### **4. Rotation indicators**

Comp	A		Z	
An	2005	2006	2005	2006
Ds	48	33	76	66
Dc	213	195	182	160
Doc	136	141	133	80

### *Rotation indicators*

The rotation indicators are vital for a better understanding of the previous analyses.

It can be noticed that the rotation period of the stocks diminished from one year to the other, which means that outputs are sold in a shorter period of time. The value of the stocks decreases which leads to a diminishment of the work capital need and it modifies the structure of the assets. As the days a stock needs to become a claim or availability are decreasing, the income from the exploitation activity amounts and automatically the level of the turn over.

Because over 24% of the claims are overdue obligations of the Ministry of Health, the collection period is very long, more then 6 months. However the situation improved by the end of 2006 when the period decreased with 18 to 22 days. The unpaid debts usually cause an increase of the need for working capital.

Previously, there has been seen that A counteracted the NWC by amounting the level of the current debts. Now, analysing the exigibility period of the temporary resources, it can be seen that A contracted loans with a flexible deadline, which concluded with an increase of the current obligations. Z, however, has a handicap at this captor. Beside the fact that the NWC amounted thanks to the unpaid obligation of the Ministry of Health, the paying period for the short term liabilities was reduced, therefore the NWC become even higher and the debt ratio diminished from 29% in 2005 to 22% in 2006.

Comparing the exigibility of liabilities with the liquidity of the claims is more then certain that the analysed companies honour their obligations from other sources, not from the claims they have towards the Ministry of Health.

### 5. The analysis of the bankruptcy risk

The risk of bankruptcy must be closely supervised to avoid a future disaster. A and Z are in a very good situation both of them being more than capable to pay their current and permanent liabilities.

There are no solvency problems, because the value of the lever is lower than 1 and the debt ratio is far under 50%. Even more; both companies are safe in case of unexpected events, due to a high gearing reserve 53,868,429 lei A and 77,968,053 lei Z.

The liquidity ratios suggest a good capacity to honour the current obligations and thanks to a high level of the acid test ratio the companies will have no problems in contracting future loans, if needed. (Banks usually ask for the minimum value of the acid test ratio to be 0.8)

Comp	A		Z	
An	2005	2006	2005	2006
LG	2.01	1.98	2.07	3.37
LP	1.66	1.75	1.50	2.83
LI	0.09	0.37	0.13	0.84
SG	3.28	3.25	3.47	4.52
levier	0.44	0.44	0.41	0.28
Rc	14.25	15.21	9.09	12.16

#### *Indicator for the analysis the bankruptcy risk*

The companies chosen for the research are both in favourable patrimonial and financial situations. They are in a financial equilibrium and to counteract the disadvantages of the industry, like the exceeding of the claim collecting deadline, the businesses have chosen to apply a defensive and prudential policy, which consists in the permanent existence of a net working capital. Besides this, they decided to auto finance their activities. The growing EBITDA and the gearing reserve of 53,868,429 lei for A and 77,968,053 lei for Z, show that they are more than capable to do so.

A and Z took both similar and different decisions. The differences were the ones that helped A to obtain a profit higher with 3% than Z, despite the fact that the turnover of Z was 64% higher than A's.

Returning to the questions from the beginning the right answer is to combine both strategies. Still it has to be underlined that a high turnover does not necessarily mean big earnings.

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