THE ECONOMIC AND FINANCIAL ELEMENTS USED IN ASSESSING THE COMPANY ACTIVITY

Cucoşel Constantin

Universitatea de Nord Baia Mare, Facultatea de Ştiinţe, Catedra de discipline economice, Str. Victoriei nr. 47/8, Email: costin.contab@xnet.ro, Telefon: 0722896131

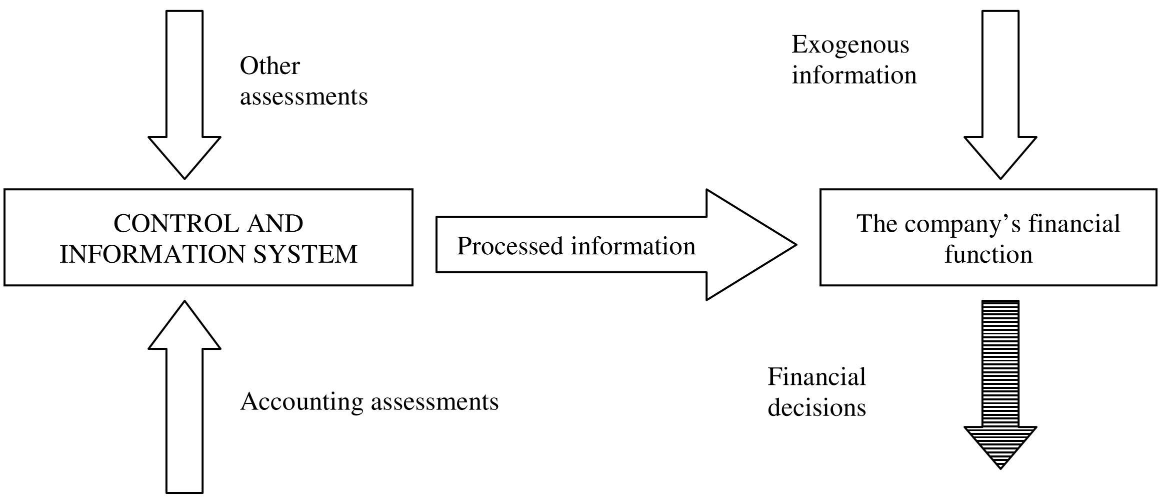
Abstract: The financial administration can be defined as an assembly of decisions and activities for regulating and adjusting financial flows and funds, at administrating the financial resources of the enterprise. The financial administration has as its aim the regular providing of the company with funds necessary to equipment and current exploitation, but also to control the good use of funds and profitability of the targeted operations. The financial administration has multiple aims subordinated to survival, to obtaining profit and economic growth of the company.

Key words: the economic elements, the financial elements, the financial resources, the enterprise

1. Indicators – concentrated expressions of the economic and financial data

According to modern conceptions with regards to the role and attributions of a company's financial function, the most common opinion is that the purpose for performing it is to make decisions concerning the cash flows that characterize the life of the company. The focus is not so much on the resource itself, but on the way it is used, which makes it necessary to emphasize the decisional aspect in performing this function.

The role of the financial function within the informational and decisional process can be illustrated through the figure below:



The data obtained and used with regards to the company performing its financial function takes the form of indicators. These become an essential tool for the financial activity and, through that, for the decision-making process at micro-economic levels.

To make it simpler, indicators may be considered to be concentrated expressions of the economic and financial data, used in the process of administrating the company. It follows from this that the first function attributed to an indicator or system of indicators, within the management process, is the function of reflecting and providing data on the phenomena involved. Because of this, indicators ensure a quantitative illustration of the structure, level, and dynamics of the phenomenon under observance. Indicators may be expressed either as absolute values at a given time or as average values over a given period, or as a secondary indicator in the form of a relative value connecting two absolute values.

Thus, in the practice of financial management these economic and financial indicators are formed as significant relations or, sometimes, as differences between two values or group of values in the income and expenditure budget, in the company's balance sheet and/or profit and loss account.

So why is it required to analyze the company's activity starting from this aspect – of the economic and financial indicators? The balance sheet of any economic agent or company, through its content, provides a static image of the capital existing at the end of the accounting period.

The calculation of these economic and financial indicators is made based on data collected from the balance sheet, the results account, as well as based on certain information that will be collected from the balance and turnover records for the completed accounting period.

I reckon that: to actually conduct this analysis based on economic and financial indicators (rate of return, financial autonomy rate, self-financing capacity, etc.), we must have access to a highly organized database of financial and accounting information, which would allow us to update the data provided by the accounting records, and access to this data must be ensured to applicants that process and draw-up documents with the financial information.

The path completed during the research represents the reverse of the phenomenon's actual evolution. The study or research starts from the results of the completed process and goes back to elements and factors from previous periods.

The content of the analysis may be described in several stages:

- Outlining the object of the analysis, which implies acknowledging certain facts, phenomena of economic and financial nature. Most often results are recorded both through absolute values and through indicators. The object is outlined in time, space, from a quantitative and qualitative point of view, utilizing certain assessment and calculation methods.
- Outlining the elements, factors, and causes of the phenomenon that is being studied. Breaking it into elements implies a structural analysis.
- Establishing the correlations between the factor and the phenomenon that is being analysed. It is required to outline the cause and effect relation.

In fact, the conclusions we will analyze must answer the following questions:

- What means are used to ensure the financial balance of the companies that are being analysed (self-financing, loans, etc.)?
- Does the company prove sufficient efficiency in utilizing its economic and financial resources?
- What are the appreciations on the structure, utility of the resources, assets, working capital?

It is answers to such questions, falling within the scope and limits of this work, that any user of the information will try to get, whether he is an insider of the company (the management of the company) or an outsider (banks, fiscal bodies, business partners).

2. An analysis on company profitability

It must be kept in mind that the financial purpose of any activity is to obtain profit, and the policy of self-financing is only a method for achieving it.

Profitability is defined as a relation between the result that was obtained and the means that were used. Most often the term of profitability refers to the result obtained from utilizing a capital.

The notion of profitability concerns a comparison between two or several values and requires the intervention of the time factor. From this point of view profitability is more than just a technical concept, as the technical concept alone cannot explain the various economic situations that we encounter in the actual life of an economic agent. At the same time profitability isn't only the result of a comparison between the technical, material, and human elements.

The essence of profitability is that it represents a monetary surplus, the balance between the total expenses and the total receipts. These elements will appear in the company's income and expenditure budget.

The income and expenditure budget is the concrete expression of the company's financial strategy, and through that it underlies the possibility to apply the development strategy over a longer period of time. The construction, and most importantly the motivation of the budgetary provisions require an in-depth horizontal analysis with the competitors in that branch, and a vertical – retrospective - analysis of the absolute values of the items included in the budget, which, taken separately, are not particularly relevant for the relation between the planned effort and the prospective results to be achieved.

This analysis involves utilising the appropriate system that would ensure clear but not imperative comparisons both vertically and horizontally. This system is formed of a group of economic and financial indicators. Five categories of indicators are known: liquidity ratios, financial balance indicators, profitability ratios, working capital indicators.

In my work I will place a special emphasis on the group of financial indicators pertaining o profitability and financial yield.

This group of indicators, which are particularly synthetic, is meant to provide the analyst with information concerning the level of economic and financial achievement obtained from the capital. They are built following the model of efficiency indicators, by calculating the relation between the effect and the effort.

I will also stress the role of these indicators starting from the significance assigned to profit in the market economy. Any entrepreneur aims to obtain sufficient profit to ensure the following:

a) convenient remuneration of the capital made available;
b) maintaining the technical and economic potential in compliance with the requirements imposed by technical and scientific progress in the company's field of activity;
c) ensuring a reasonable expansion on the market, taking into account its evolution and the conjectural tendencies it manifests.

This profit results from a group of activities and operations that work together for the achievement of the targets assumed by the enterprise, in compliance with its market strategy. It follows from this that the profit is a method, a signal (information), and a result of the concentrated actions that the company performs in basis of its functions.

As a consequence, the indicators for financial yield and profitability are meant to outline these very aspects and to serve the act of management precisely by providing the most relevant information with regards to profit and profitability.

There are two separate kinds of selective indicators within this group, and they are as follows:

a) financial yield indicators;
b) profitability indicators.

2.1. Financial yield indicators

The following are included in this type of indicators:

a1 – the gross profit coefficient (margin), established through the relation:

$$m_{pb} = \frac{P_b}{C_A}$$

a2 – the net profit coefficient (margin), established through the relation:

$$m_{pn} = \frac{P_n}{C_A}$$

Both values indicate to the analyst the proportion (margin) that it holds in the whole of the company's receipts. At the same time, these indicators reflect the financial yield for the company business, by indicating how many monetary units represent profit, per received monetary unit, following the sale of the products. Obviously, the purpose is to have this coefficient reach a level as high as possible, and to make its evolution an increasing one.

2.2. Profitability indicators

This group contains indicators obtained from the general relation "profit/capital assets".

Based on the calculation values that are taken into account, we may discriminate between several types of profitability ratios, and they are as follows:

b1 – profitability ratio of the share capital, calculated with the following formula:

$$r_{CS} = \frac{P_b}{K_S}$$

Profitability ratios are rather economic than financial in nature, that is why this appears more like a financial yield indicator for the share capital. In this framework, it may be argued that this indicator reflects the capacity of the share capital to produce profit.

b2 – profitability ratio of the share capital, calculated with the following formula:

$$r_{CS} = \frac{P_n}{K_S}$$

It may be argued that this indicator is purely financial in nature, and this is actually the one indicator that expresses the capital's profitability. It is extremely utilized in the practice of companies located in countries with well established market economies, and it is acknowledged as an indicator of the efficiency of the company's administrators in utilizing the plant assets made available to them.

3. Economic and financial aggregates

Financial analysis makes use of two types of aggregates: the first kind is derived from the financial balance sheet and they constitute the fundamental relation of the bank vault, the second kind originates in the profit and loss account and they form the intermediary balances of administration. The fundamental relation of the bank vault provides indications with regards to the company's financial structure, while the intermediary balances of administration provide information on the administration, as suggested by the name itself.

3.1. The fundamental relation of the bank vault

To establish the fundamental relation of the bank vault three aggregates must be taken out of the balance sheet:

a) The net working capital (F.R.N.)
b) Working capital requirement (N.F.R.)
c) Net bank vault (T.N.)

A) *The net working capital* is the essential element for appreciating the financial structure of a company. It is used for measuring the conditions of the financial balance that results from the confrontation between the liquidity of the assets and the payability of the resources.

The net working capital is the permanent capital surplus relative to the net fixed assets, that is the share of the permanent capitals that is used for financing the circulating assets.

F.R.N. = C.P. – A.I.N.

The attention paid to financial security and caution leads us to state a rule according to which sustainable utilization must be financed through sustainable sources, that is through permanent capitals. This implies the fact that the net working capitals must have positive values. A negative net working capital indicates that some of the fixed assets are financed through short-term resources. Such a situation is deemed to be an important factor of vulnerability. Still with the aim of ensuring financial security, a second problem that needs to be addressed is establishing whether the net working capital should finance the operating cycle and if yes, up to what point. As a general rule, the net working capital may be considered as indicating good financial health if it meets the following criteria:

- it is equal to half the stocks;
- it varies between 1 and 3 months of the average turnover, without taxes.

Thus, the net working capital allows us to draw the following conclusions:

- a positive net working capital is a favourable signal in that which concerns solvency;
- a zero-value net working capital indicates tension over the liquidity and is a sign of a certain vulnerability with regards to solvency;

- a negative net working capital indicates difficulties in that which concerns solvency, if no corrections are made to improve the stability of the financing.

B) *The working capital requirement* outlines the financing requirements created by the operating cycle. The difference between the financing requirements of the operating cycle (the circulating assets) and the operating debts is called the working capital requirement.

N.F.R. = A.C. – D.E.

That is to say:

WORKING CAPITAL REQUIREMENT = CYCLIC ALLOTMENTS – CYCLIC SOURCES

As a rule, companies must deal with a very high working capital requirement. If this difference is positive, it indicates a surplus of temporary (cyclic) requirements in relation to temporary (cyclic) sources that could be mobilized. Such a situation can be deemed as normal if it is the result of an investment policy with regards to the increase of the financing requirements for the operating cycle.

If the working capital requirement is negative it indicates a surplus of temporary requirements in relation to the corresponding requirements for circulating capitals. This can receive a positive appreciation if it results from an acceleration of the rotation of circulating assets and of taking up debts with more relaxed due dates.

The evolutionary character of the working capital requirement lies in the fact that this requirement depends on the activity volume, and its size may be inflected through administration measures (reducing the stocks, reducing the number of clients or increasing the credit of suppliers).

The whole of the resources that the company can self-procure, having as source the self-financing and the divestiture.

The self-financing is based on the forecasts for the gross operating output resulted from the operations. The gross operating output depends on the profitability of both the existing capital and the new added capital. Starting from the gross operating output, the calculation for self-financing requires mainly an establishment of the financial expenditure and income, as well as a calculation of the tax and of the participations to the profit.

Forecasting financial expenditure is a very delicate issue, since the financial expenses related to treasury credits (short-term credits) are treasury requirements themselves. But the very existence of the bank vault depends on the chosen financial policy. The chain procedure is advised. Also, another element that must be taken into account is the policy for distributing benefits, in the case of dividends received from subsidiaries.

Divestitures represent selling of certain asset elements to allow the procurement of significant capitals. One must discriminate though between the divestitures that are consequences of completing new investments, and divestitures caused by a deliberate choice with regards to the company’s capital.

Conclusions

When a company chooses a financing source, whether it is short-term, medium-term or long-term, it must have certain criteria based on which it can make a selection. For this decision, as with other decisions made by the financial leader, the final criterion is maximizing the wealth of the shareholders. But this criterion has more than one dimension as several factors need to be taken into account when making a choice between debts, potential actions and common actions. Among these are the following: cost, fund availability, company control, changes in the structure of the capital, opportunity cost, taxes, etc.

From the management’s point of view, the impact over the cash flow is one of the most important factors taken into account when making the financing decisions.

The company is left with money supplies that it may use either to complete the distribution of the dividends or to purchase subsidiaries or participations, thus becoming a “parent” company of a group or holding. Still, it is required to examine the nature and size of the balance (surplus). If it shows a tendency of keeping a high level (as a consequence of the unitary strategy), the company may also consider a policy of remunerating shares and external development. But if this balance shows a reverse tendency, there is a risk that the company may get in a negative situation.

This analysis (research) indicates that there is a strong connection between the company’s strategic situation and its financial performances.

At the same time, a company's financial performances shouldn't be measured only in terms of profitability but also, using flows, in terms of capacity, generating liquidities, equally conducted at the level of strategic activities.

Without having exhausted all the aspects of business administration in the field of *self-financing,* we have tried to analyse and discuss some aspects that we found useful.

Bibliography :

1. Berceanu, D., *Finanţele întreprinderii*, Editura Logos, Bucureşti, 1995
2. Cucoşel, C., *Finanţele întreprinderii,* Editura Risoprint, Cluj-Napoca, 2004
3. Hoanţă, N., *Gestiunea finanţelor firmei*, Editura Tribuna Economică, Bucureşti, 1999
4. Manolescu, G., *Managementul financiar*, Editura Economică, Bucureşti, 1995
5. Mărgulescu, D., *Analiza economico –financiară a întreprinderii*, Editura Tribuna Economică, Bucureşti, 1995
6. Olaru, Delia S., *Economia şi gestiunea întreprinderii*, Editura Tribuna Economică, Bucureşti, 1999
7. Sabou, C.A., Loşonţi, A., *Management financiar bancar*, Editura Didactică şi pedagogică, Cluj – Napoca, 1997
8. Stan, S., *Evaluarea întreprinderii*, Editura Teora, Bucureşti, 1996
9. Stancu, I., *Gestiunea financiară a întreprinderii*, Editura Domino, Bucureşti, 1993
10. Trenca, I., *Managementul financiar al întreprinderii*, Editura Mesagerul, Cluj – Napoca, 1997
11. Vintilă, G., *Gestiunea financiară a întreprinderii*, Editura Didactică şi Pedagogică R.A., Bucureşti, 1997