CONTEMPORARY APPROACHES OF COMPANY PERFORMANCE ANALYSIS BASED ON RELEVANT FINANCIAL INFORMATION

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In this paper we chose to present two components of the financial statements: the profit and loss account and the cash flow statement. These summary documents and different indicators calculated based on them allow us to formulate assessments on the performance and profitability on various functions and levels of the company's activity.
This paper aims to support the hypothesis that the accounting information presented in the profit and loss account and in the cash flow statement is an appropriate source for assessing company performance. The purpose of this research is to answer the question linked to the main hypothesis: Is it the profit and loss statement or the cash flow account that reflects better the performance of a business?
Based on the literature of specialty studied we tried a conceptual, analytical and practical approach of the term performance, overviewing some terminological acceptations of the term performance as well as the main indicators of performance analysis on the basis of the profit and loss account and of the cash flow statement: aggregated indicators, also known as intermediary balances of administration, economic rate of return, rate of financial profitability, rate of return through cash flows, operating cash flow rate, rate of generating operating cash out of gross operating result.
At the same time we had a comparative approach of the profit and loss account and cash flow statement, outlining the main advantages and disadvantages of these documents.
In order to demonstrate the above theoretical assessments, we chose to analyze these indicators based on information from the financial statements of SC Sinteza SA, a company in Bihor county, listed on the Bucharest Stock Exchange.
Keywords: accounting information, performance, result, profitability, cash flow.
JEL codes: M41, M21

Introduction
In the socio-economic space in which it operates, an economic entity must constantly prove its economic and financial performance. For business performance analysis we chose to present two components of the financial statements: the profit and loss account and the cash flow statement.

Company performance - concept, content, approaches
Reviewing the literature we can say that currently the term 'performance' has a high degree of complexity and can have different meanings: a positive result of an activity, competitiveness, profitability, productivity, adaptability, growth, efficiency, satisfaction, success, achievement (Jianu 2007: 12-23).
Some authors define the notion of performance as "the degree to which a company meets the requirements of the economic environment both internal and external through an optimal combination of effectiveness and efficiency" (Buşe 2005: 136).

In the American literature no clear distinction is made between performance analysis by the rates of return and those of profitability, the two concepts are often used interchangeably (Pinches 1990). The continental literature, who is of French inspiration, expresses a negative attitude towards the confusion of the concepts of profitability / return and their use as synonyms (Vernimmen 1988: 313).
The literature in Romania claims that profitability is an economic category which reflects the company's performance (Petrescu 2008: 31) and represents the ability of an enterprise to make profits by using factors of production and capital, regardless of their origin (Robu and Georgescu 2000: 190). A complex research of the concept of performance is achieved by Julia Jianu, who concludes that "performance is a state of competitiveness of the enterprise which ensures sustainable presence on the market” (Jianu 2007: 24).

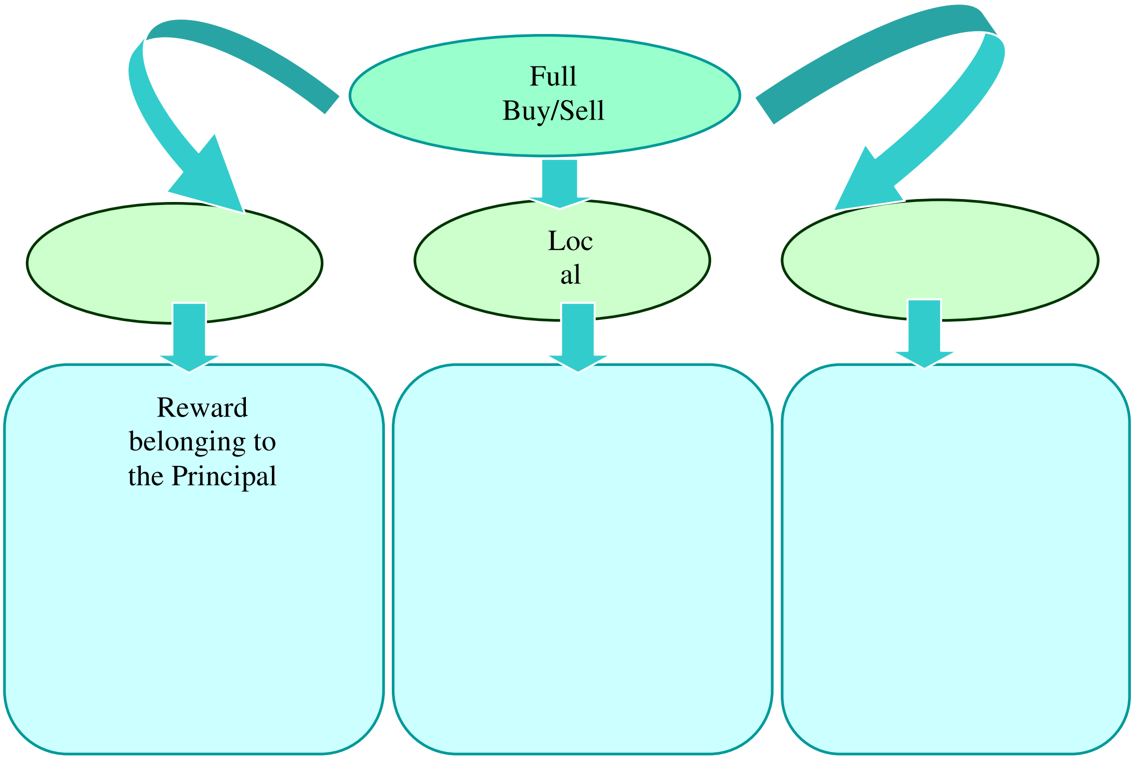

Figure 1 Approaching the term performance
(Own projection)

We believe that the components of financial statements reflect the different aspects of the same events and transactions. Thus for evaluating the performance of an economic entity it is not sufficient to analyze only the *profit and loss account*, but we must take into consideration *the cash flow statement* and other non-financial information.

Profit and loss account - the traditional tool for assessing the company’s performance
Most companies have as main objective to maximize the profit, so traditionally the company performance is evaluated based on profit, reflected in the profit and loss account. The profit and loss account gives a retrospective view of the operations that influenced the financial result of the exercise (Moscviciov 2011: 75) and explains the way the result of the exercise is formed as an expression of partial or global adjustments between different types of income and expenses (Mironiuc, 2006: 342). This analysis expresses the firm’s profitability on various levels.

For measuring the profitability we can use two categories of indicators: the profit and the rates of return.

I. ***The profit*** expresses in ***absolute values*** the business' profitability and it is "the main component of wealth of a society and reflects both the company's performance and the capacity of the company to reinvest and pay dividends" (Mironiuc 2006: 237).

In the analysis of the profit as it is presented in the profit and loss account we must consider its components, whose aggregation leads to the building of a series of aggregated indicators, also known as intermediary balances of administration.

<table>
<tr><td rowspan="7">Operating income
=
Turnover
+
Other operating income</td><td>Material expenses</td><td rowspan="2"></td><td rowspan="3"></td><td rowspan="4"></td><td rowspan="5"></td></tr>
<tr><td>Staff expenses</td></tr>
<tr><td rowspan="5">EBITDA = (RBE, EBE) (Earnings Before Interest, Taxes, Depreciation Amortization); Gross operating result</td><td>Amortization Depreciation Other operating expenses</td></tr>
<tr><td rowspan="4">EBIT= (RE) (earnings before interests and taxes) Operating result</td><td>Financial income – Financial expenses</td></tr>
<tr><td rowspan="3">Current result</td><td>Extraordinary income– Extraordinary expenses</td></tr>
<tr><td rowspan="2">Gross result</td><td>Income tax</td></tr>
<tr><td>Net result</td></tr>
</table>

Figure 2: The formation of the net result and its aggregate indicators
(*Model adapted from Moscviciov 2011: 184*)

II. ***The rates of return*** express in relative indicators the profitability of a company and represent the enterprise's efficiency in using its capital and resources at different levels. Profitability reflects the level of remuneration of capital, and we could speak about return only when the surplus obtained by the investor is compared with the invested capital (Ştefea 2002: 271).

1. The economic rate of return reflects the relationship between economic results and economic means employed to achieve it. In the literature we can distinguish several formulas for calculating this indicator, depending on which we have different names for the indicator (Pierre 2004: 25-32; Niculescu 2003: 215-222):

a) The economic rate of return on total capital or assets (Ret), known in Anglo-Saxon literature by the name *"Return On Assets" (ROA),* is a global measure of profitability that highlights the capacity of the total capital of the enterprise, materialised in its patrimony, to generate profit, and is calculated as the ratio between gross profit and total assets.

b) The economic rate of return on invested capital (Rei) - is established as the economic rate of return - in French literature, or Return On Investment (ROI) - Anglo-Saxon literature. The rate expresses the level of remuneration on the capital gains, determined as the ratio of the result before interest payments and income tax (EBIT) or the operating result and the capital invested.

c) The economic rate of return on employed or permanent capital (ROCE - Return On Capital Employed) – means the profit that the company gets from the money invested in the business and is determined as the ratio of the result before interest payments and income taxes (EBIT) and the capital employed.

2. *The rate of financial profitability or the rate of equity's profitability*, known in the Anglo-Saxon literature as the *"Return On Equity" (ROE)*, and in the French as *"financial rate of return" (Rf),* allows *assessment of the efficiency of shareholders' equity investments and of the appropriateness of keeping* them and is calculated as the ratio between the net income for the year and the equity.

Cash flow statement - modern tool for performance measurement

The analysis method based on cash flow is a more modern financial analysis compared with the classical one, based on the financial statement relying on tables of financial flows. Producing the cash flow table is mandatory for listed companies and large companies according to IAS 7, and optional for small and medium size enterprises that apply simplified accounting rules.

The ensemble of the financial flows complete the analysis of the entity's performance by a more dynamic and more global approach that enables reconstruction of the financial flows of the period according to the nature of operations, thereby identifying the existence of any cash difficulty of the entity (Petrescu 2008: 306-310).

Structure of the cash flow statement

The cash flow statement should highlight the existence, movement and transformation of cash along the financial year, related to the entity's activities, classified into: operating activities, investing activities and financing activities.

An entity shall report the cash flow statement using the direct method, which requires the use of the information in the balance sheet, to determine the flow of receipts and payments and the indirect method, which is based on information from the balance sheet, income statement and explanatory notes having as starting point the profit or loss of the year adjusted with the items not affecting the treasury of the entity.

Main indicators calculated in the cash flow statement

The information provided by the cash flow statement allows calculations of several financial ratios, of which we mention here:

- *Rate of return through cash flows*, determined as the ratio of cash flow from operations and the capital invested - provides managers with information on the profitability of investment in terms of operating results;
- *Operating cash flow rate* - a measure of the entity's ability to discharge current liabilities by use of the operating cash flows (Buşe 2005: 335-336).
- *Rate of generating operating cash out of gross operating result* – shows the ratio to which the gross operating surplus generates effective cash corresponding to the operation.

Profit and loss account versus cash flow statement - comparative approach

Table 1 Comparative approach of the profit and loss account and cash flow statement

Profit and loss account	**Cash flow statement**
General aspects	
Main purpose : Presenting *a genuine image* of the entity.	
Traditional, static presentation	More *modern, dynamic* presentation
Reflects the *expenses and incomes* by their nature.	Reconstructs *financial flows* of the period according to the functions of the operations.
Allows calculation of the *global result*.	Calculates the *treasury variation.*
The assessment of the enterprise's ability to *generate profit*.	The assessment of the company's capacity to *generate cash* or cash equivalents.
Information about *profitability and return.*	Information about *liquidity and payment capacity.*
Advantages	**Disadvantages**

It is mandatory for all companies.	It is a mandatory document only for *big companies.*
Highlights all revenues and expenditures of a financial exercise, explaining the formation of the *result*.	Explains only the *variation of liquidities* on different levels of the activity.
Permits the assessment of enterprise profitability, the cash flows not being significant in this respect.	Is *influenced* by the policy of liquidation of claims and of debt servicing.
Disadvantages	**Advantages**
Potential cash flows. A high profit does not mean that there is more cash.	*Actual cash flows.* You cannot spend profit, you spend money!
Can be manipulated by the company's management, by the adoption of decisions with negative effects on long-term	It cannot be easily manipulated in favour of management, because it is not influenced by the accounting policies adopted.
Does not consider the risk of failures to receive payments (even in the case of provisions).	Takes into account only *the amounts actually received.* Highlights the differences between spending, usages and payments and also between incomes, resources and collections.

(Own projection)

In order to demonstrate the above theoretical assessments, we chose to analyze these indicators based on information from the financial statements of SC Sinteza SA, a company in Bihor county with tradition in Romanian chemical industry, listed on the Bucharest Stock Exchange.

Assessment of performance on the basis of the profit and loss account

Table 2 Structure indicators of the result for the period 2009-2011

Indicator	2009	2010	2011
Gross operating result (EBE=EBITDA)	1 059 958	405 068	-786 249
Operating result (RE = EBIT)	418 281	145 387	- 1 479 491
Gross result (RB)	619 925	33 637	-1 330 486
Net result (RN)	479 528	15 329	-1 330 486

Source: www.sinteza.ro

Analyzing the indicators we can see that the entity is becoming less efficient, recording declining profits in the 2009-2010 period, while in 2011 the result of the activity is loss. While in 2009 the gross and the net results are higher than the operating result, in 2010 the situation is changed, and in 2011 the company registers losses on all levels of the indicators of result.

Table 3 Rates of return for the period 2009-2010

Name of indicator	Calculating formula	2009	2010
1. Economic rate of return			
a. Economic rate of return on total capital (ROA)	$= \frac{\text{Gross profit}}{\text{Total assets}} \times 100$	0.36 %	0.019 %
b. Economic rate of return on invested capital (ROI)	$= \frac{\text{RBE (EBITDA)}}{\text{Invested capital}} \times 100$	1.65 %	1.20 %
c. Economic rate of return on capital employed (permanent) (ROCE)	$\frac{\text{RE (EBIT)}}{\text{Total assets- Current debt}} \times 100$	0.25 %	0.083 %
2. Return on equity (ROE)	$= \frac{\text{Net result}}{\text{Equity}} \times 100$	2.28 %	0.009%

During 2009-2010 we can notice that the main economic rates of return and the return on equity record an unfavourable downward evolution. In 2011 the results take the form of losses, so we cannot talk about profitability.

One cannot say that the company is efficient, unless the economic rate of return is at least at the level of the minimum rate of return in the economy (the average interest rate: 6-8%, source www.bnr.ro) taking into account the economic and financial risk assumed by the shareholders and the creditors of the company. From the analysis of various forms of economic profitability rate in 2009-2010 we can see that they recorded values below the average interest rate.

The return on equity shows a significant downward trend, reflecting the decreased ability of the company to release net profit through the equity employed in the activity.

Performance assessment based on cash flow statement

Table 4 Indicators determined on the basis of the cash flow statement

Indicator	Calculating formula	2010	2011
Operating cash flow *(FTE)*	FTE = EBE - Δ NFRE	1 041 416	1 832 030
Total cash flow (net cash variation) (*FNT)*	FNT = FTE + FTI + FTF (operating, investment, financial cash flows)	1 995 684	- 3 270 847
Rate of return through cash flows	$\frac{\text{Operating cash flow}}{\text{Invested capital}}$	1.15 %	1.05 %
Operating cash flow rate	$\frac{\text{Operating cash flow}}{\text{Current debt}} \cdot 100$	24.30%	29.25 %
Rate of generating operating cash out of gross operating result	$\frac{\text{Operating cash flow}}{\text{Gross operating result}}$	2.57	-

Source: www.sinteza.ro

The evolution of *operating cash flow* in the period under review is favourable, recording a growth. The cash flow surplus resulting from the operation is a source of supporting the needs of the investment and financing activities during the period. The drop in gross operating surplus usually drives the reduction of the operating cash flow, but the decrease of the working capital

needs generated an increasing operating cash flow. This is a favourable aspect on the company's operating activities.
Overall, the *total cash flow* decreased in 2011 compared to the previous financial exercise, passing from surplus to shortage of cash, leading to assessing of the alteration of the enterprise's financial position as a bad one at the end of 2011, mainly as an effect of funding policy, with the entity not calling on new sources of funding. The cash flow from investing activities was negative in the period analyzed due to significant payments for purchased assets.
The rate of return through cash flows shows a slight decrease and records low values, a negative aspect upon the return on investment.
The operating cash flow rate shows a rising trend, the debts arising from the activities of the entity being covered at a rate of almost one third by the operating cash flow.
The rate of generating operating cash out of gross operating result registered a value higher than 1 in 2010, reflecting a positive operating cash flow, higher as compared to the gross operating result, due to lower operating working capital needs. In 2011 based on an operating deficit, a positive operating cash flow is generated, reflecting the gap between the time of recording the money income / spending and the time of their collection / payment, as well as the existence of elements of revenue and expenditure that do not generate cash flows.

Conclusions

Following the theoretical and empirical research we can support the validity of the main hypothesis, that the relevant accounting information presented in the profit and loss account and in the cash flow statement is an adequate source for assessing the company's performance and may be influenced by non-financial information.
The conclusions of the analysis of performance of the company Sinteza SA are as follows:
- *on the basis of the profit and loss account* we can notice that the company's performance fell in the period 2009-2011, reflected by the decrease of the overall results and of the values of the rates of return, passing from profit to loss, which is an unfavourable evolution.
- *from the analysis of performance based on cash flows*, we found that during 2010-2011 the company's performance is limited to *operating activities*, reflected in a *growing surplus of liquidity,* meaning a positive aspect and the *total cash flows* shifted from a cash surplus in 2010 to a cash deficit in 2011, as a result of the investing and financing policy.
In our opinion the assessment of the performance of an enterprise is the result of a process of complex analysis, whereby we must take into account the most relevant information sources.

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