

THE IMPORTANCE OF INDEBTEDNESS AND PROFITABILITY INDICATORS IN ASSESSING THE PERFORMANCE OF SMEs

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Abstract: *This study aims to present the importance of the information provided by financial accounting in assessing the performance of economic entities in the form of SMEs. In this regard, a study was conducted that presents structural data on the economic and financial indicators of the largest SMEs, by turnover in 2023, from each of the five Counties of S-W region of Oltenia, Romania. Subsequently, the assessment of the performance of these SMEs was taken into account by calculating and analyzing the main debt and return indicators. The research methodology used was based on the analysis of the documents available on the website of the Ministry of Finance in Romania. The research question was: Is the financial and accounting information provided by the annual financial statements relevant in assessing the performance of SMEs? The results showed that the annual financial reports of SMEs facilitate the monitoring and evaluation of performance with the help of economic and financial indicators. Knowledge and use of financial and accounting information relevant to the economic entity represents the fundamental raw material in the adoption of the managerial decisions. Financial and accounting information represents the starting point of any form of analysis used to establish the realistic, objective and useful economic and financial situation of a SME, at a given time. The path to achieving performance by SMEs is directly connected to the quality and relevance of the financial and accounting information provided by the annual financial statements. The dynamics of the economy, the current social and economic conditions, the complexity of the activities of SMEs in competitive economic circumstances with major influences on managerial decisions, require the abandonment of routine and force the identification of new possibilities for increasing the relevance of financial and accounting information in the context of performance evaluation.*

Keywords: *financial-accounting information; profit and loss account; performance; financial statements; indebtedness indicators, return indicators.*

JEL Classification: M41

1. Introduction

The financial and accounting information provided by the financial statements is of interest, in particular, to users who make final decisions within economic entities. The information in the financial and accounting statements is the final product of accounting. Due to the clear, reliable, complete and operational nature of the financial and accounting information, it represents the main support for decisions made inside and outside the entity. The quality of the annual financial statements of SMEs significantly affects their performance, while improving competitiveness, transparency and reputation (Auliyah I., et al., 2024).

The balance of the profit and loss account highlights the performance of the economic entity transposed into its ability to generate, in the future, cash flows using the resources it has (Țilică E., V., et al, 2019). The role of the balance sheet is to present information about the financial position of the economic entity, namely about assets - known as controlled economic resources and about debts and equity - known as financial structures through indicators such as liquidity and solvency (Petrescu S., 2010). Correct financial reporting reflects current performance and helps predict future performance, crucial for assessing value and sustainability (Zhou E., et al., 2022).

The relevance is the ability of financial and accounting information to influence the decision of end users, being influenced by its nature and the significance threshold (Drăgan O., 2019). The general conceptual framework of financial reporting mentions that relevant financial information can influence the adoption of decisions if it has predictive value, confirmation value or both. Predictive value allows the use of financial information as inputs in the processes applied by users to predict future results (Luță, 2021). High-quality annual financial statements are characterized by comparability, reliability, understandability, and relevance, all of which are essential for stakeholders to make informed decisions (Tanjaya A., et al., 2022).

2. Debt and Return Indicators

In order to carry out this study, two categories of indicators were used, namely debt indicators and return indicators. The two categories of indicators are further discussed along with the identification of the main indicators in each group. Debt and return indicators are of particular importance for managers as their knowledge allows for the adoption of much more assertive decisions regarding cost savings and investments. The most relevant debt indicators are the total debt ratio and the equity solvency. The total debt ratio expresses the ratio between debts and total assets and is a risk indicator that is of particular interest to credit institutions. SMEs with a debt ratio below 0.50 can benefit from external funds to support their activity. Equity solvency is calculated according to the ratio $\text{Equity} / (\text{Debt} + \text{Prepaid Income} + \text{Provisions} + \text{Equity})$. The most common return indicators in the specialized literature are the net profit margin, the financial return (Return on Equity-ROE) and the return on total assets (Return on Assets-ROA). The net profit margin is calculated according to the relationship $\text{Net Profit} / \text{Turnover}$. A net profit margin

between 1% and 15% reflects a stable situation of the economic entity. ROE is calculated according to the relationship Net Profit/Equity and measures the profit made from the investment made by the administrators. ROA is calculated according to the relationship Net Profit/Total assets and measures the efficiency of the capitals allocated to total assets, being independent of the financing policy.

3. Study on the importance of financial and accounting information in assessing the performance of an SME

3.1. Research methodology

The study used a descriptive, evaluative research method, which covered 5 SMEs in Romania. For the purpose of the research, the largest SMEs in the S-W region of Oltenia, Romania were selected by accessing the website <https://membri.listafirme.ro/pagini/p1.htm>. The selection of SMEs was made after applying the following filtering criteria: selecting SMEs from each of the five counties of the region and classifying them according to the size of their turnover in 2023. Thus, the selected SMEs are: S.C. MARIGAB COM S.R.L. (<https://www.listafirme.ro/marigab-com-srl-15094917/>), S.C. NURVIL S.R.L. (<https://www.listafirme.ro/nurvil-srl-8517267/>), S.C. FLAGAS S.R.L. (<https://www.listafirme.ro/flagas-srl-10066630/>), S.C. BIZ SOLUTIONS S.R.L. (<https://www.listafirme.ro/biz-solutions-srl-11057665/>) and S.C. CONVALARIA S.R.L. (<https://www.listafirme.ro/convalaria-srl-7015688/>). The economic and financial indicators were presented and the performance of these SMEs was assessed by calculating and analyzing the main debt and return indicators.

3.2. The results of the research

The annual financial statements provide information that allows highlighting the positive and negative aspects of financial management, aspects that can be used to substantiate managers' decisions. The most important indicators found in the annual financial statements for the five SMEs are presented in Table 1, as follows:

Table 1. Structured data on economic and financial indicators

	SME Name	Heritage component elements	Year			
			2023		2019	
			lei	euro	lei	euro
1	S.C. MARIGAB COM S.R.L.	Equity	35231026	7082183	9105457	1905186
		Debts	15624987	3140953	1930475	403924
		Net turnover	145041513	29156417	39788660	8325207
		Gross profit	13271700	2667893	3259338	681970
		Net profit	11625434	2336959	2758185	577111
		Average number of employees	198	198	77	77
2	S.C. NURVIL S.R.L.	Equity	64175527	12900641	26603215	5566341
		Debts	58752153	11810428	53517824	11197837
		Net turnover	432605891	86962950	315020738	65913573
		Gross profit	21328499	4287480	13216265	2765314
		Net profit	18897449	3798788	11430284	2391623
		Average number of employees	166	166	158	158
3	S.C. FLAGAS S.R.L.	Equity	55215986	11099583	11812930	2471686
		Debts	67827469	13634758	10884989	2277528
		Net turnover	738978158	148550267	112561114	23551799
		Gross profit	20240563	4068782	10200693	2134349
		Net profit	17434729	3504750	8786605	1838471
		Average number of employees	143	143	117	117
4	S.C. BIZ SOLUTIONS S.R.L.	Equity	94174243	18931018	26535558	5552185
		Debts	70517216	14175455	72134861	15093185
		Net turnover	304240850	61158857	210177508	43976630
		Gross profit	1024925	206032	7071157	1479538
		Net profit	958016	192582	6167582	1290478
		Average number of employees	36	36	47	47
5	S.C. CONVALARIA S.R.L.	Equity	10047565	2019773	6552746	1371068
		Debts	33749110	6784286	24444476	5114656
		Net turnover	85942303	17276224	55423572	11596588
		Gross profit	718642	144462	2125864	444807
		Net profit	548275	110215	1847550	386573
		Average number of employees	129	129	102	102

Source: own processing based on the annual financial statements of the analyzed SMEs

The values in the table are expressed in lei and euros, the exchange rate for the euro on 31.12.2019 being 4.7793 lei, and on 31.12.2023 4.9746 lei.

For S.C. MARIGAB COM S.R.L., the turnover registered a jump of 365%, from 39.79 million lei to 145.04 million lei. Total revenues increased by over 100 million lei, which also determined a favorable evolution of profit in the analyzed period.

S.C. NURVIL S.R.L. registered a 138% increase in turnover with the increase in total revenues from 319979642 lei in 2019 to 434644139 lei in 2023. Net profit increased by 7467215 million lei, which indicates that the entity is performing in the field of activity.

For S.C. FLAGAS S.R.L. Turnover registered significant increases, by over 600 million lei, reaching 738978158 million lei in 2023. During the analyzed period, increases were noted in all assets, which is also reflected in the value of net profit, which in 2023 reached 17434729 million lei. S.C. BIZ SOLUTIONS S.R.L recorded significant decreases in net profit, by over 5 million lei compared to 2019. S.C. CONVALARIA S.R.L. recorded an increase in turnover, by over 30 million lei, proportional to total revenues that show significant increases. Net profit fluctuated throughout this period, the most unfavorable year being 2023, when the entity recorded only 548,275 lei.

The situation of the last two SMEs analyzed requires long-term attention in terms of contracting loans to maintain the activity.

In order to assess the performance of the analyzed SME, the main financial balance indicators were analyzed, according to Table 2, as follows:

Table 2. Financial balance indicators

Crt. np.	SME name	Indicator name		Year	
				2023	2019
1.	S.C. MARIGAB COM S.R.L.	Debt indicators	Total debt ratio	0.28	0.17
			Asset solvency	0.64	0.82
		Return indicators	Net profit margin	8.02	6.93
			Financial return (Return on Equity-ROE)	0.33	0.30
			Return on total assets (Return on Assets-ROA)	0.21	0.25
2.	S.C. NURVIL S.R.L.	Debt indicators	Total debt ratio	0.46	0.63
			Equity solvency	0.51	0.33
		Return indicators	Net profit margin	4.37	3.63
			Financial return (Return on Equity-ROE)	0.29	0.43
			Return on total assets (Return on Assets-ROA)	0.15	0.14
3.	S.C. FLAGAS S.R.L.	Debt indicators	Total debt ratio	0.54	0.47
			Equity solvency	0.45	0.51
		Return indicators	Net profit margin	2.63	7.81
			Financial return (Return on Equity-ROE)	0.32	0.74
			Return on total assets (Return on Assets-ROA)	0.14	0.38
4.	S.C. BIZ SOLUTIONS S.R.L.	Debt indicators	Total debt ratio	0.43	0.73
			Equity solvency	0.57	0.27
		Return indicators	Net profit margin	0.31	2.93
			Financial return (Return on Equity-ROE)	0.01	0.23
			Return on total assets (Return on Assets-ROA)	0.01	0.06
5.	S.C. CONVALARIA S.R.L.	Debt indicators	Total debt ratio	0.77	0.79
			Equity solvency	0.23	0.21
		Return indicators	Net profit margin	0.64	3.33
			Financial return (Return on Equity-ROE)	0.05	0.28
			Return on total assets (Return on Assets-ROA)	0.01	0.06

Source: own processing based on data provided by the website listefirme.ro

Taking into account the information in Table 1, the analysis of the situation of SMEs is presented as follows:

Debt indicators:

a) *The total debt level* is a risk indicator that is of interest especially for institutions that grant loans. SMEs that have a debt level below 0.50 can benefit from external funds that allow supporting the activity. SMEs that have the lowest debt level is S.C. MARIGAB S.R.L, an SME that presents credibility and stability (Figure 1). At the opposite pole is the economic entity CONVALARIA S.R.L., which leads to a reservation on the part of banking institutions regarding the granting of loans.

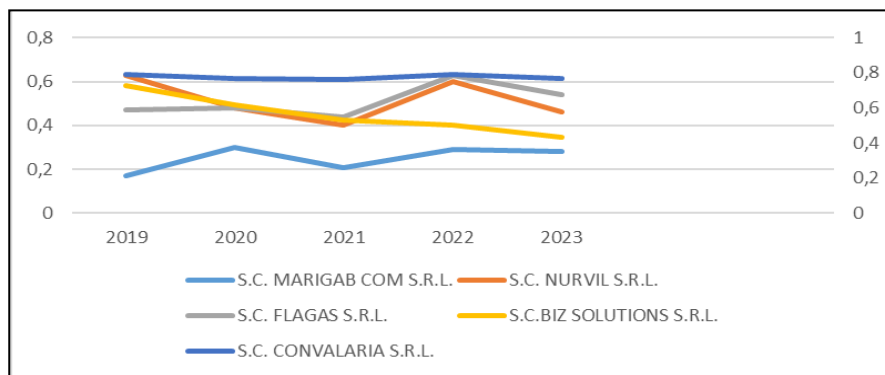


Figure 1. Total debt ratio

Source: own processing based on data provided by the listefirme.ro website

b) Good *equity solvency* is observed in four of the five SMEs, S.C. CONVALARIA S.R.L. failing to exceed the 50% threshold in any of the years analyzed (Figure 2). The highest equity solvency is recorded by S.C. MARIGAB COM S.R.L. with 0.82 in 2019 and 0.64 in 2023, which means that there is a financial balance that allows long-term debt to be covered from equity.

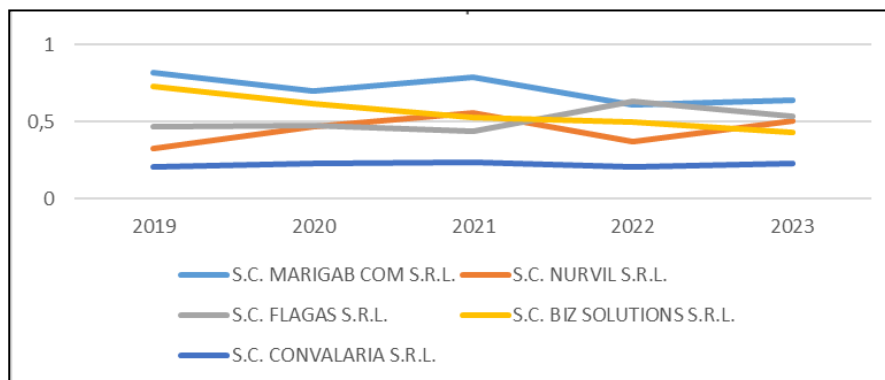


Figure 2. Asset solvency

Source: own processing based on data provided by the listefirme.ro website

Return indicators:

a) The net profit margin between 1% and 15% reflects a stable situation of the economic entity. The highest net profit margin is 8.02 recorded by S.C. MARIGAB COM S.R.L. in 2023, and the lowest value of this indicator of 0.31 is held by S.C. BIZ SOLUTIONS S.R.L. also in 2023 (Figure 3). A net profit margin between 1% and 15% reflects a stable situation of the economic entity.

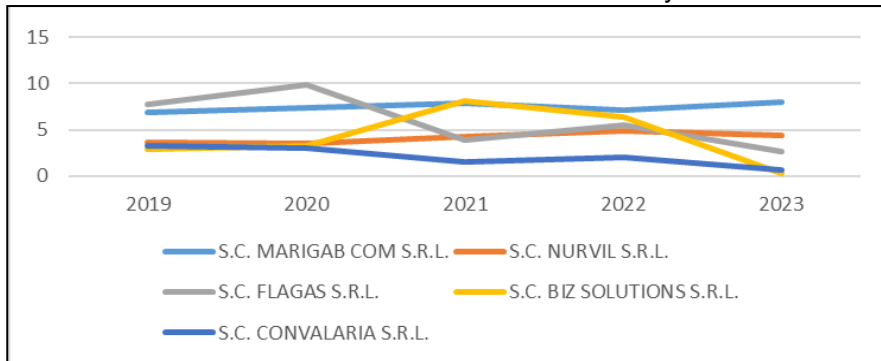


Figure 3. Net profit margin

Source: own processing based on data provided by the listefirme.ro website

b) *Financial return (Return on Equity-ROE)* measures the profit made from the investment made by the administrators. ROE provides a view of the performance of the economic entity in terms of how the assets are used to generate profit. In general, a high ROE indicates that the respective economic entity generates a high return on assets, and a low ROE may indicate a low return or even losses. All of these SMEs manage to have a good performance on equity (Figure 4).

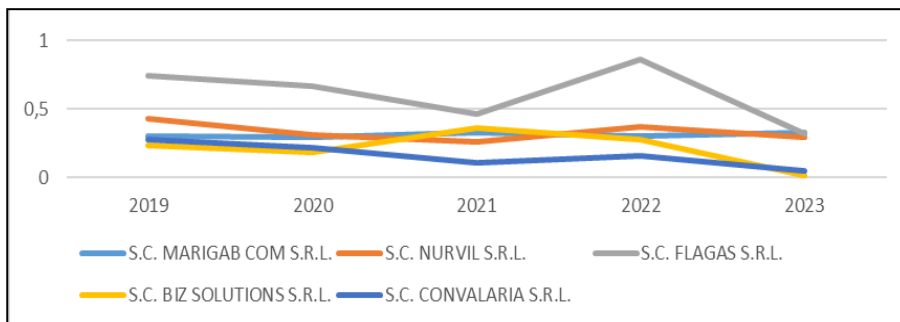


Figure 4. Financial return

Source: own processing based on data provided by the listefirme.ro website

c) *Return on total assets (Return on Assets-ROA)* measures the efficiency of capitals allocated to total assets, being independent of the financing policy. The rate level must be positive and as high as possible. The optimal reference interval is

between 5% and 15%, and the SMEs presented above mostly fall within the interval, thus recording a good economic performance (Figure 5).

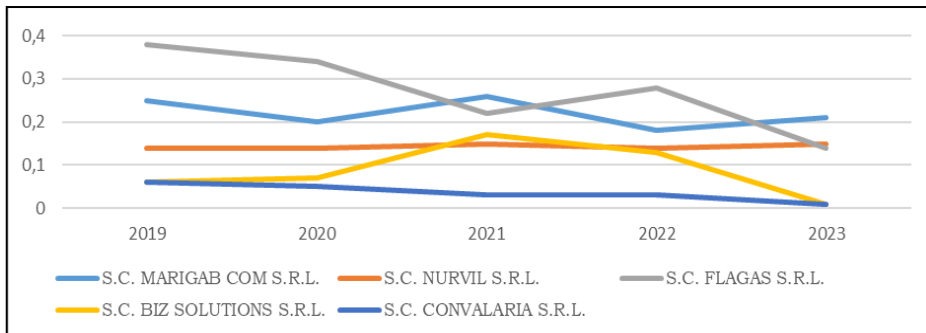


Figure 5. Return on total assets

Source: own processing based on data provided by the listefirme.ro website

4. Conclusions

The results of this research have highlighted that determining the performance of SMEs is directly related to the influence of the quality and relevance of financial and accounting information in the annual financial statements. The superior use of financial and accounting information involves informing administrators about the performance, efficiency, effectiveness and economy with which SMEs' resources were managed.

Analyzing the results obtained by applying the indicators to the financial situation of the five SMEs analyzed, we can observe the following aspects:

- the values of the debt ratio indicator reflect a positive evolution in the analyzed period, with three of the five SMEs managing to register values below 50%, which confers stability on business risk in the following period;
- in terms of asset solvency, we note an improvement in this indicator with values above the 50% threshold in over half of SMEs, compared to 2019 when only two of them were above this level. These values indicate a financial balance that allows long-term debt to be covered from equity;
- compared to 2019, in 2023 S.C. MARIGAB COM S.R.L. and S.C. NURVIL S.R.L. record increases in net profit margin, which reflects stability and the achievement of the established objectives. At the opposite pole, SMEs S.C. BIZ SOLUTIONS S.R.L. and S.C. CONVALARIA S.R.L. fail to record values above the 1% threshold, thus presenting an unstable future situation;
- financial return is positive throughout the period 2019-2023, the SMEs analyzed managing to have a good return on equity;
- the optimal reference interval for the return on total assets is between 5% and 15%, and the SMEs presented above mostly fall within the interval, thus recording a good economic performance.

Following the research conducted, the answer to the research question - *Is the financial and accounting information provided by the annual financial statements relevant in assessing the performance of SMEs?* is affirmative, since the information

contained in the annual financial statements allows for knowledge of the financial balance, establishing the return of the economic activity and implicitly assessing the performance. Annual financial statements represent the most important means by which financial and accounting information is made available to managers in order to assess their performance. In the study conducted, we aimed to synthesize a model for analyzing the performance of SMEs using debt and return indicators. The limits of the research were represented by the availability of data contained in the annual financial statements. Future research directions can be extended to the analysis of the structure of assets, liabilities and equity. Also, the performance of an SME can be assessed using the self-financing capacity, liquidity and solvency, but also by establishing rates of return.

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