

## **THE RETURN - A MEASURE OF ECONOMIC AND FINANCIAL PERFORMANCES. A CASE STUDY FOR ROMANIAN INDUSTRIAL COMPANIES**

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**Abstract:** Measuring the economic and financial performances of a company is a very complex activity and involves taking into consideration several quantitative and qualitative indicators, which have in view the entire activity of the company. Out of all the economic and financial indicators used to measure the performances of the enterprises, in this paper we took into consideration the profit, in all its forms. The study was conducted on 17 Romanian industrial companies listed on BSE, for the period 2005-2007.

**JEL classification:** G32, G34

**Key words:** return, profit, performances, industrial enterprises

### **I. Introduction**

Regardless its activity field, the activity of an enterprise can be characterized in terms of its effects and the way the objectives are achieved. In such a context, it is necessary to know which of the recorded results may be associated with the concept of performance, on the terms of respecting the restrictions imposed by the sustainable development. The diversity of terms of the concept of performance demonstrates that it is defined differently by the financial information users, according to their interests. Thus, the managers are targeting their company's overall performance, the current and potential investors assess the performance through the return on their investment, the employees are interested on the stability and profitability of the company, the creditors on its solvency, and customers, for the company's stability [4: 84]. Therefore, to measure a certain level of performances, a system of indicators is used, characterizing all sides of the activity run. Under this system, we emphasize the indicators that characterize the return, since they reflect the results obtained in all stages of the economic circuit.

**The return**, as a synthetic form of expressing economic efficiency, reflects the company's ability to generate a financial surplus, in the form of profit, from its activities. For the company, this is the condition for survival and development. In an open and competitive economy, a permanent pursuing of the return is set as a rule.

The return expresses the efficiency of the financial and material resources invested in the enterprise's global activity, measuring the profitableness of the allocated means or their relative ability to bring profit. Analyzing the return means comparing the

results with the means used to achieve them. The main indicators used to express the return for a company are the profit and the rates of return.

## II. Concepts and methodology

The profit is a component of the selling price of goods or services made by a company and it is determined by the expected profit margin [1; 35]. The profit is achieved when the overall revenues of a company exceed the total expenditures. According to some authors, the total costs should also include the so-called *hidden costs*, as the owner's wage, the rent of the own building used etc. [3: 145]. "Profit is a consequence of risk", a reward that the shareholder can receive for risking its capital.

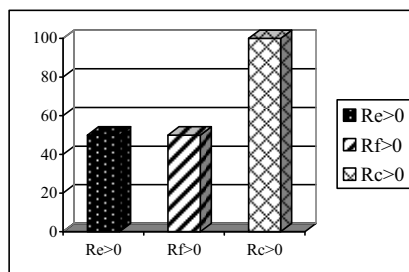
In economic theory and practice we meet many forms of profit. In accordance with the revenue and expenditure structure from the Profit and Loss Account, we have the following forms of profit: operating profit OP, financial profit FP, current profit CP, extraordinary profit EP, total profit TP, net profit NP.

A profitable enterprise at first glance may face difficult situations that may lead to suspending activity. This vulnerability may arise from the inability of making payments as a result of lack of liquidities. Breaking up the result into its constituent parts (operating, financial and extraordinary result), as well as their correlated analysis reflect different situations in which a company can find itself, namely [1: 44]:

### A. Full financial "health"

$$OP > 0, FR > 0 \Rightarrow CR > 0$$

It involves obtaining a positive current result on the basis of a positive operating and financial result. The graphic representation for this case is presented in figure no 1:



**Figure no. 1 Full financial "health"**

The following aspects are characteristic for this situation:

- ✓ the company has a strong position in the market;
- ✓ the operating activity is profitable;
- ✓ the financial policy not only allows the recovery of any possible financial expenditure, but also obtaining additional profits.

### B. Classical situation

$$OP > 0, FR < 0, OP > |FR| \Rightarrow CR > 0$$

In this case, the current result is positive, due to a positive operating result, which allows coverage for loss arising from the financial activity. The graphical representation for this case is presented in figure no 2:

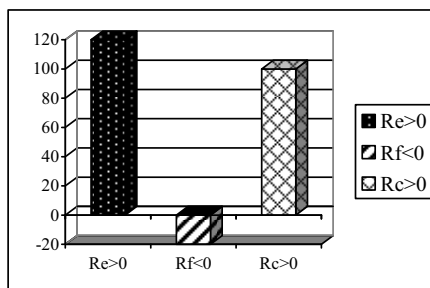


Figure no. 2 Classical situation

The following comments can be made:

- ✓ for industrial or services companies is a normal and common situation;
- ✓ the company has a profitable operating activity, part of the operating profit being used to cover the financial expenses;
- ✓ the risk the enterprise faces depends on the sustainability of the operating profit.

### C. Financial "Blessing"

$$OP < 0, FR > 0, |OP| < FR \Rightarrow CR > 0$$

The current result is positive, as the surplus is generated by the financial activity only. The operating activity generated losses, which were covered however by the surplus arisen from the financial activity. The graphical representation for this case is presented in figure no 3:

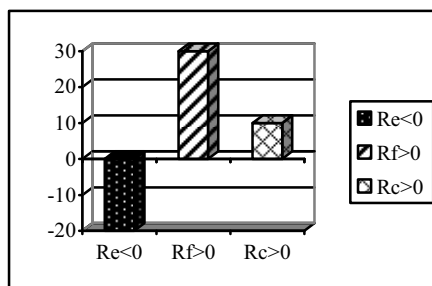


Figure no. 3 Financial "Blessing"

In this case, the following comments can be made:

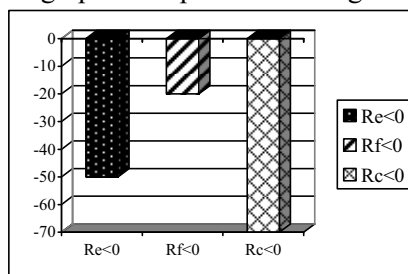
- ✓ the positive current result arises from the substantial revenues resulted from the financial investments;
- ✓ there are losses in the operating activity which may have the following explanations:
  - an operating deficit reflects an alarming situation, despite the positive current result;
  - if the main source of income are the financial investments, then the operating losses are justified, given that a financial company, for example, should cover its compulsory operating expenses (administrative expenses, wages etc.).

- a company may abandon or reduce its operating activities, by transfers to another unit, if this one is the component of a holding company.

#### **D. "Brinkmanship"**

$$OP < 0, FR < 0 \Rightarrow CR < 0$$

The current result is negative, as the loss is generated by both the operating and the financial activity. The case is graphical represented in figure no 4:



**Figure no. 4 "Brinkmanship"**

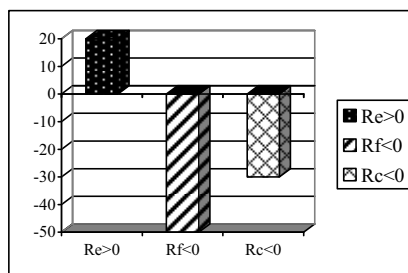
The following aspects are characteristic for this variant:

- ✓ the company is in real distress because of the losses recorded in the current activity;
- ✓ the operating activity is unprofitable, reflecting a poor management of the patrimony;
- ✓ the high financial expenses worsen the current deficit;
- ✓ it is necessary to define a strategy to restore the financial balance.

#### **E. "Vicious circle" of financial expenses**

$$OP > 0, FR < 0, OP < |FR| \Rightarrow CR < 0$$

The company records losses from the current activity, although it posts operating profit. The operating profit was however insufficient to cover the financial expenses, so as the company's activity is unprofitable. The graphical representation for this case is presented in figure no 5:



**Figure no. 5 "Vicious circle" of financial expenses**

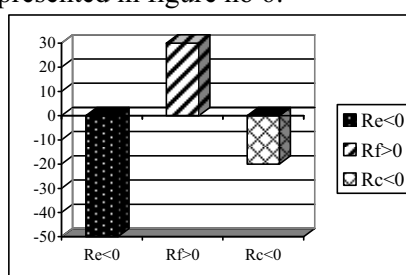
In connection with this situation, the following comments can be made:

- ✓ if the enterprise is growing rapidly and the situation is temporary, it can be tolerated if only its situation will improve itself in the next period by increasing the operating profit;
- ✓ the high financial expenses can be explained by the debts incurred;
- ✓ the situation requires maximum caution as regards the risks and efficiency of the company's investments, financial and investment policies.

#### F. Financial incomes - the last "bastion"

$$OP < 0, FR > 0, |OP| > FR \Rightarrow CR < 0$$

The current result is negative, because the surplus generated by the financial activity was not sufficient to cover the losses from the operating activity. The graphical representation for this case is presented in figure no 6:



**Figure no. 6 Financial incomes - the last "bastion"**

Characteristic for this situation is that, although apparently there is a bad administration of the business, sanctioned by a poor current result, it may hide two economic realities, subtle at first sight, namely:

- ✓ the company faces a highly competitive environment, and the financial income derived from the investments partially cover trade deficiencies;
- ✓ the financial surplus and the current negative result can also be explained by the poor performances of a financial holding company oriented exclusively to making high-yield financial investments.

### III. Results

To analyze the return of Romanian enterprises, we have selected a total of 17 industrial companies listed on the Bucharest Stock Exchange, for which we processed the financial statements for a three year retrospective period (2005-2007). Companies included in the survey are dispersed throughout the national territory and cover the main industrial sub-branches. They fall into the category of large enterprises, as they are representative for the sector they belong to. The identification data of these firms is presented in Appendix A.

For the analysis we used three indicators:

- the operating result;
- the financial result;
- the current result.

During the period considered, the analyzed firms had not recorded extraordinary incomes and expenditures. In these circumstances, the current result was

equal to the total result of the financial exercise, so the analysis was made on the basis of the latter.

The indicators analyzed were taken from the financial accounting statements of each company and can be found in Annexes B and C.

Analyzing this data, we found that in the year 2005 the 17 companies achieved a combined operating profit of 20,056,194 lei. Of these, 5 firms have registered losses from the operating activity, of which 4 have losses also from the financial activity, so that the total result for them was also negative. The fifth firm has achieved profit from the financial activity, which covered the loss from the operating activity, the overall result being positive. The other 12 firms had registered operating profit, while from the financial activity the firms had registered losses lower than the operating profit, globally companies recording profit.

In 2006, the combined operating profit increased to 84,739,719 lei, four times higher than that achieved in the previous year. Profit was also obtained from the financial activity, of 11,674,518 lei, the overall result being positive and increasing spectacularly compared with 2005. As regards the distribution of the operating profit on the companies, it is noticed that this year also, 5 companies had losses. Of these, 4 had losses in the previous year too, thus having profitability problems. SEVERNAV and ELECTROARGEŞ continued to obtain significant incomes from the financial activity, which have covered the losses from the operating activity, remaining only 3 companies with losses from the overall activity.

In 2007, the combined operating profit of the 17 analyzed companies continued to grow, reaching 125,750,423 lei. The financial activity has not generated profit any more, 14 companies had losses, so the overall profit was with 10.5% lower than the one recorded in 2006. This year, only 2 companies had losses from the operating activity, losses increased by the deficit recorded in the financial activity. Moreover, the financial loss registered by ROMCARBON could not be covered by the operating profit, this company also having a negative overall result in 2007.

Placing each analyzed company (depending on the operating result, the financial result and the total result) in one of the 6 categories listed above, we obtain the following distribution:

**Table no. 1: The distribution of the analyzed companies by the correlation OP, FR, CR**

	Category	2005	2006	2007
OP > 0	A. - Full financial "health"	0	4	3
	B. - Classical situation	12	8	11
	C. - Financial "Blessing"	1	2	0
OP < 0	D. - "Brinkmanship"	4	1	2
	E. - "Vicious circle" of financial expenses	0	0	1
	F. - Financial income - the last "bastion"	0	2	0
	Total	17	17	17

It is noted that most companies are in case B - Classical situation, in which the operating result is positive and large enough to cover the loss in the financial activity, thus resulting a positive overall result. In 2005, we find an important group of companies (4 companies) in case D - "Brinkmanship", for which both the operating result and the financial result have negative values. The situation changed in 2006 when

one company only is in this situation, two of them going in case F and another one in case A.

In 2007, the profitability of the 17 firms continued to improve, 14 of them having a positive overall result, finding themselves in areas A and B, 2 in case C (brinkmanship) and one in case E, when the overall loss was generated by the financial activity.

In conclusion, based on the absolute return indicators, during the period 2005-2007, a few companies encountered financial distress, but most fall into the category of profitable enterprises. In addition, during the considered period, the trend has been to improve the profitability of the firms, with benefic effects on their performance.

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Băndoi A.

## APPENDIX

### Appendix A: Companies selected in the survey

No	Company name	No	Company name
1.	ALBALACT	10.	MAT Craiova
2.	ARGUS	11.	PRODLACTA
3.	ARTECA	12.	ROMCAB
4.	ARTEGO	13.	ROMCARBON
5.	BEGA TEHNOMET	14.	SAMUS MEX DEJ
6.	DUCTIL	15.	SEVERNAV
7.	ELECTROARGES	16.	TRANSILANA
8.	IPROEB	17.	UPET
9.	LAFARGE AGREGATE SI BETOANE		

**Appendix B: Operating Result and Financial Result**

<i>Simbol</i>	<i>Re</i>			<i>Rf</i>		
	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>
ALBZ	4337646	6337738	9258126	-645787	985140	-5440685
UARG	-6298559	-10864370	8085581	-2968774	125746	-2872593
ARJI	-630461	29095109	2148267	-415753	3487	-301181
ARTE	4634040	8606667	17971164	-2358414	-2817674	-2805336
TEHO	931802	8745897	2528372	-727464	-353301	-1179504
DUCL	15849553	18583902	15146748	-63456	622770	2072286
ELGS	1114972	-374828	2536421	-792449	779557	-1295319
IPRU	4088813	17766607	28304163	-882487	-858802	908289
AGEM	4451114	14326481	21137441	-1106691	-1683797	-2555046
MAT	399742	2458840	13907238	-204718	-606636	-1200263
PRAE	1146545	812645	1280235	-795352	-317081	-680156
MCAB	1488760	1957300	1284834	-1376802	-138800	2290856
ROCE	4630954	5410004	4413896	-219121	198532	-5352984
SAMU	-1297750	-4130961	-9097980	-3694381	-2931830	-5821286
SEVE	-205063	-2172959	-1187314	1374338	15361093	-12811607
TRSK	982348	425310	1144562	-767950	-298165	-1053212
UPET	-15568263	-12243663	6888669	-3907049	3604279	-1314460
TOTAL	20056194	84739719	125750423	-19552310	11674518	-39412201

**Appendix C: Current Result and Net Profit**

<i>Simbol</i>	<i>Rc</i>			<i>Pn</i>		
	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>
ALBZ	3691859	7322878	3817441	3127564	6024614	3236032
UARG	-9267333	-10738624	5212988	-7719149	-10738624	5212988
ARJI	-1046214	29098596	1847086	-1046214	29098596	1847086
ARTE	2275626	5788993	15165828	1770833	4569291	12502822
TEHO	204338	8392596	1348868	96632	6809186	810859
DUCL	15786097	19206672	17219034	13356864	15758578	13887323
ELGS	322523	404729	1241102	24664	87319	1036217
IPRU	3206326	16907805	29212452	2342422	13801214	24892823
AGEM	3344423	12642684	18582395	2655068	10298718	16018014
MAT	195024	1852204	12706975	205710	1205466	10911231
PRAE	351193	495564	600079	210454	313059	380866
MCAB	111958	1818500	1720530	91177	1519800	1243672
ROCE	4411833	5608536	-939088	3714396	4790909	-974567
SAMU	-4992131	-7062791	-14919266	-4992131	-7062791	-14919266
SEVE	1169276	13188134	-13998921	1169276	12356750	-13998921
TRSK	214398	127145	91350	167864	79724	68745
UPET	-19475312	-8639384	5574209	-19643091	-8639384	5574209
TOTAL	503884	96414237	84483062	-4467661	80272425	67730133