

The Financial Performance of the Companies Approached from the Perspective of Commercial Banks

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Abstract: Assessment of financial performance of a company aims at highlighting the economic potential and its financial capacity to generate future cash flow. To support the granting of a loan any commercial banking institution goes through several steps of the formal and informal analysis of the applicant. Within the analysis takes into account a system of indicators characterizing the last and future performance of the company. The paper presents the steps taken by a commercial bank in the lending process with customizing the system of indicators used by Raiffeisen Bank in characterizing the financial performance of businesses ranging from small and medium enterprises (SMEs).

Keywords: financial performance, the company's creditworthiness analysis, indicators of financial-accounting statements

JEL Classification: G21, G30, G39

1. Introduction

Financial performance is the fundamental objective of the organization and functioning of any economic entity. Through its multiple meanings and methods of quantification (profitability, cost-effectiveness, positive cash flows, liquidity, solvency, economic value added, etc.), economic and financial performance is the common point of the interests of all participants, whether direct or indirect, to the activity of a firm. From shareholders and associates, managers, credit institutions, trading partners or state agencies, any decision concerning participation as well as the longevity of such participation to a firm is judged in relation to the performance which it recorded.

Users with different interests will measure and expressing the firm performance from different angles corresponding to their interests through indicators. Of all categories of users previously listed, this paper deals with the financial performance of the company from the perspective of commercial banks, in their capacity as creditors of its activity and thus of actors with interest in the financial results of the company.

According to these users, the performance of the company "takes the appearance of financial reliability by reference to liquidity, solvency, financial structure and risk hanging over its ability to honor its debt principal and service"(Ganea M., 2012, p.126).

We justified the importance of our scientific approach, focusing on how a commercial bank judges the financial performance of an enterprise, by the acute and growing need of the Romanian economic operators to fund their activities through bank loans.

2. Concepts and methodology

Evaluation of the financial performance of a company is done "according to the internal rules of credit institutions, based on the scores assigned to the quantitative

and qualitative factors" (Bătrâncea I., 2013, p.17). The score obtained for analysis places the company in a class of financial performance according to which it will lay down the conditions for granting the loan.

Lending operations to businesses is the main class of business activities of the commercial banks. According to the dictionary of banking¹ *lending is an operation whereby the bank provides customers, or undertakes to place at the disposal of customers, the required funds.* The banks may grant loans to their customers on short-term loans, medium-term loans and long-term loans in local and foreign currency.

The credit means any undertaking for payment of a sum of money in exchange for the right to a refund and the payment of interest or other expenses related to the amount or any extension of the due debt and any commitment to acquire a title that incorporates a debt or other right to the payment of a sum of money².

In the operation of lending to companies, banks analyze the creditworthiness of customers and evaluate the risk of the credit loan operation. Lending activity stages are played in the following figure:

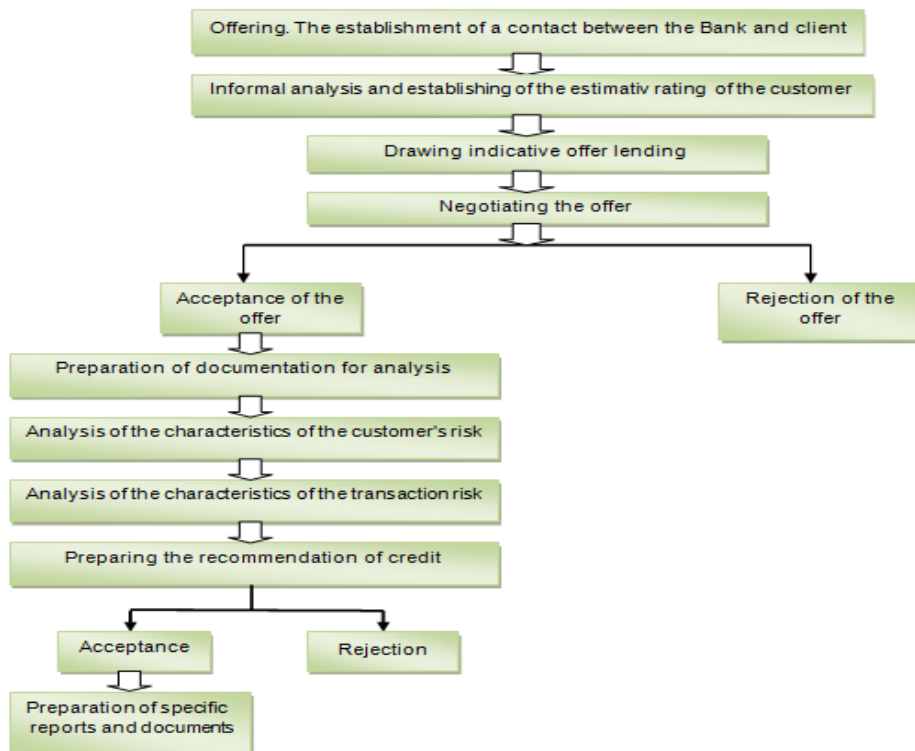


Figure 1 Stages of the lending operation of legal persons

In the first four stages of the operation of lending the bank establish a first contact with his client, prepares an indicative offer of lending following an informal analysis based both on direct interview with the client, visits to headquarters, and on the basis of a brief financial analysis. If, on the basis of the informal analysis, results that the applicant has a good business plan, an estimated rating which corresponding to the rules of risk assumed by the banking institution and indicative offer of lending is

¹ http://www.money.ro/dictionary/dictionary-financial-banking/operation_of_crediting.html

² Banking Law no. 58/1998

assumed by the client, the official of the bank will invite the legal representative of the company at the credit service to submit the necessary documentation to form loan application and going through other phases of the lending operation.

Next steps after accepting the indicative offer of lending are detailed in the following paragraphs.

2.1. Preparation of the loan documentation for analysis

Within this stage is collected the documents necessary to carry out the analysis of client's creditworthiness in granting loans.

Companies will submit a set of documents in order to describe their creditworthiness, which will consist mainly of:

- ✓ loan application submitted by the authorized persons of the company;
- ✓ financial-accounting statements:
 - Financial statements for the last two financial years completely ended (balance sheet, profit and loss account, annual management report) and the related balances signs and stamps;
 - The least balance completed, sign and stamp in original;
 - The situation forecast for revenue and payments during the period of the loan (cash-flow);
 - Contracts and charts for credit facilities/ leasing ongoing for the loan requester;
 - Sheets analytical account for the top 3 suppliers and customers since the last balance;
 - Sheets analytical account with main customer and main supplier in terms of turnover (volume of purchase / sale);
 - Contracts and orders from customers - if necessary (ex. : factoring, other contracts that provide reimbursement);
 - Contracts and orders with suppliers - if necessary (ex. Acquisition of equipment/ property, construction);
 - Documents relating to credit insurance: pledge, mortgage, bank guarantee, bank deposit, bond, cash collateral; the list of proposed guarantees, bank documents confirming ownership of the assets pledged as collateral; documents confirming property insurance of goods guaranteed;
 - Business plan;
 - Any other financial documents required by the bank.
 - ✓ Legal documents:
 - The articles of incorporation and all amendments along with proof of registration with the Trade Registry;
 - Statute, the founding agreement, decision setting (for individual enterprise);
 - The extract from the Commercial Register confirming the person empowered to manage the company and the owners of the company;
 - Identity documents for legal representatives and their wives and any authorized persons, including the mandate - if necessary;
 - Certificate of recognition (applicant and group companies) - original;
 - Fiscal certificate of the applicant – original;
 - Documents relating to litigation, bankruptcy and garnishments declared – if necessary (according to the Declaration on own responsibility from micro questionnaire);
 - The extract from the minutes of the General Meeting of Shareholders approval of the loan application; on the authorization of the person with the right to represent the company and sign all documents of credit and guarantee loans with company assets;
 - License on the types of activity, certificate confirming certain activities;

- Any other legal documents required by the bank.

Besides financial and legal documents required by the bank, the company will provide a range of non-financial information relating to shareholders and the management of the company.

The documents submitted by the companies in order to contract a loan, together with documents prepared by the lending bank at all stages will be filed separately, constituting the content of each client credit file, the file will be stored at the Loans Department³.

2.2. Analysis of the customer's risk. The analysis of its performance

Based on the documentation submitted by the client the bank shall analyze its financial performance in order to determine the risk characteristics of its business and the conditions of granting the loan.

The necessity and importance of "economic and financial analysis of the customer arises from the bank's need to know all the elements necessary to support decision in lending" (Trenca I., 2004, p.179).

In the literature this stage is also known as "analysis of the creditworthiness of the loan applicant, being exposed as one of the most important stages in the process of lending" (Trenca I., 2004, p.179). This is because, during this stage, banks assess and determine, based on quantitative and qualitative indicators, the customer's ability to repay at maturity the loan and interest contracted.

Based on the creditworthiness indicators, the bank can be able to highlight the financial situation of the entity marked by "strong" and "weak" points, which will make the lending decision well-reasoned (Tiurluc V., Cocriș V., 1997, p. 294).

The basic steps of customer creditworthiness analysis are:

- Assessment and quantification of the creditworthiness based on the financial indicators of performance (quantitative indicators);
- Assessment and quantification of the creditworthiness based on the non-financial indicators of performance (qualitative indicators);

Quantitative indicators calculated in the analysis of customer creditworthiness are represented (with slight differences from one bank to another): liquidity, patrimonial solvency, profitability, margins, coverage of interest indebtedness.

Qualitative indicators refer to the quality of management, ownership structure, market position, economic structure of the sector.

3. Case study

Analysis of the creditworthiness of the applicant company and therefore, the possibility of contracting a bank loan to finance its core business, will be based on the performance criteria applied by Raiffeisen Bank. In pursuit of this case study, we consider hypothetical data for the company, S.C. PROFESIONAL S.R.L., in the category of small and medium-size enterprises (SMEs), data presented in Annex 1.

To grant a financial credit, Raiffeisen Bank analyzes the following system of indicators, both quantitative and qualitative, to the level of a company:

³ After the granting of the bank loan the documents shall be sent to the archive. If the debtor will have debts to the bank, the file will be forwarded to the Department of management of problematic loans.

Table no.1 System of indicators of Raiffeisen Bank

No. crt.	Criteria to assess	Share	Values	Degree
Quantitative criteria				
1	General liquidity (G_L) ($G_L = \text{Current assets} / \text{Current liabilities}$)	18%	>1,5 1,2-1,5 1,0-1,2 0,8-1,0 <0,8	1 2 3 4 5
2	Solvency (S) ($S = \text{Total assets} / \text{Total liability}$)	18%	>1,5 1,25-1,5 1,0-1,25 0,8-1,0 <0,8	1 2 3 4 5
3	Operating profit margin (O_{pm}) ($O_{pm} = \text{Operating profit} / \text{Net turnover}$)	12%	>10 7-10 3-7 0-3 <0	1 2 3 4 5
4	Interest coverage ratio (I_{cr}) ($I_{cr} = \text{Operating profit} / \text{Interest expense}$)	18%	>4 3-4 2-3 1-2 <1	1 2 3 4 5
5	Equity ratio (E_r) ($E_r = \text{Equity} / \text{Total assets}$)	9%	>60 50-60 30-40 20-30 <20	1 2 3 4 5
Qualitative criteria				
1	Quality of management	21%	-	-
1.1	Experience in the business of the company, management team, clear business strategy, good reputation	-	1	-
1.2.	Experience in the business of the company, management team, business strategy under development, good reputation	-	2	-
1.3.	Limited experience in the business of the company, management team, business strategy under development, good reputation	-	3	-
1.4.	Limited experience in the business of the company, new management team, business strategy under development	-	4	-
1.5.	Dependence on one man, lack of strategy, limited experience in the field of activity of the company	-	5	-
2	Shareholder structure	4%	-	-
2.1.	The majority is held by a strong international company	-	1	-
2.2.	The majority is held by a average international company	-	2	-
2.3.	The majority is held by a weak international company	-	3	-
2.4.	The majority is held by a strong local company	-	1	-
2.5.	The majority is held by a average/weak international company	-	3	-
2.6.	The majority is held by countries in the A category and the Romanian state	-	1	-
2.7.	The majority is held by countries in the B category	-	4	-
2.8.	The majority is held by management	-	2	-
2.9.	The majority is held by population	-	3	-
2.10.	The majority is held by de investing found	-	4	-
2.11.	Obvious problems with shareholders/disputes with	-	5	-

No. crt.	Criteria to assess	Share	Values	Degree
	owners-			
2.12.	Shareholders' structure is not known	-	5	-

Source: The norms of Raiffeisen Bank

After analyzing the financial statements of S.C. PROFESSIONAL S.R.L. have been determined financial and non-financial indicators used by the bank, their level being centralized in the following table:

Table no.2 Financial and non-financial indicators for S.C.PROFESIONAL S.R.L.

No. crt.	Criteria to assess	2013	2014	Degree
Quantitative criteria				
1	General liquidity (GL)	3,77	2,36	1
2	Solvency (S)	2,10	1,84	1
3	Operating profit margin (Opm)	0,09	0,11	4
4	Interest coverage ratio (I_{cr})	2,74	2,55	3
5	Equity ratio (E_r)	38	32	3
Qualitative criteria				
1	Quality of management	-	-	-
	Experience in the business of the company, management team, business strategy under development, good reputation	2	2	-
2	Shareholders structure	-	-	-
	The majority is held by a average/weak local company	3	3	-

Source: Own processing

Analysis of S.C. PROFESIONAL S.R.L. creditworthiness based on the previously calculated indicators and the firm's classification in the weighting coefficients used by Raiffeisen Bank, led a scoring 2.19 points.

Under the rules of Raiffeisen Bank a company, requesting a bank loan, can be assigned according to the scoring obtained in the following categories of financial performance:

Table no.3 Categories of financial performance

Scoring	Financial performance (customer rating)	Loan type
1,00-2,00	A	Standard
2,01-3,00	B	In observation
3,01-4,00	C	Substandard
4,01-4,50	D	Doubtful
4,51-5,00	E	Loss

Source: Norms of Raiffeisen Bank

Scoring obtained by the company placed it in the B performance category, being associated with the type of credit *in observation*.

4. Conclusion

The financial performance of a company is characterized by banking institutions on the basis of strict criteria, centralized in the form of a model based on assessment scores, which put the financial rating of the customer at a certain time. The purpose of such a characterization of the performance of a company is the determination of the creditworthiness and financial condition of default risk which the bank incurred in

relation to lending activity.

Raiffeisen Bank is one of the most restrictive commercial banks in terms of lending to economic entities, referring to the top 10 banks in the Romanian banking system. Its policy is based on financing with minimum risk.

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Banking law nr. 58/1998.

http://www.money.ro/dictionar/dictionar-financiar-bancar/operatiune_de_creditare.html

Annex no. 1. Table 1. Balance sheet

Indicators	No. rd	31.12.2013	31.12.2014
Fixed assets			
I. Intangible assets	1	640537	785512
II. Tangible assets	2	90470906	101872595
III. Financial assets	3	591352	648856
Fixed assets total (rd. 01 la 03)	4	91702795	103306963
Current assets			
I. Stocks	5	21025861	23528312
II. Receivables	6	34197375	41064704
III. Short term investments	7	145684	
IV. Cash	8	2344439	2216173
Current assets total (rd. 05 la 08)	9	57713359	66809189
Expenses in advance	10	248008	64670
Debt of less than one year	11	15271703	28230894
Net current assets/ current liabilities net (rd. 09 + 10-11-18)	12	426889664	38642965
Total assets minus current liabilities (rd. 04 + 12-17)	13	113704300	119176017
Debts older than one year	14	55772856	63899137
Provisions for risks and expenses	15	0	0
Revenue in advance (rd 17 + 18) of which:	16	20688159	22773911
-subsidies for investments	17	20688159	22773911
-revenue recorded in advance	18	0	0
Capital and Reserves			
I. Capital (rd20 la 22) of which:	19	16052544	16052544
- subscribed capital non-paid	20	0	0
- subscribed capital paid-in	21	16052544	16052544
- overhead heritage	22		
II. Share premium capital	23	34532569	34532569
III. Revaluation reserves	24		
V. Reserves (rd26 29)	25	1327606	1510584
1. Legal reserves	26		
2. Statutory or contractual reserves	27		
3. Reserves representing reserve surplus	28		
4. Other reserves	29	1327606	1510584
V. Reported result	30		
Balance D	31		
Balance C	32	3093758	2791761
VI. The result of the financial exercise	33		
Balance D	34		
Balance C	36	3903554	3659553
Allocation of profits	36	195178	182978
Equity - Total	37	57931444	55276880
Public patrimony	38	0	0
Capital Total (rd. 32+33)	39	57931444	55276880

Table 2. Profit and loss account

Indicators	No. rnd	31.12.2013	31.12.2014
Turnover	1	81784790	76504983
Production sold	2	81382123	73959634
Revenue from sale of goods	3	402667	2551293
Income from subsidies related to net turnover	4		
Changes in inventories			
- balance C	5		1902255
- balance D	6	9212952	
Capitalised production	7	4398575	3205259
Other operating revenues	8	975920	1643348
Operating income total (1+5+6+7+8)	9	77946333	83255845
Raw materials and consumables	10	33008999	30208959
Other material expenses	11	1051833	1666483

Indicators	No. rnd	31.12.2013	31.12.2014
Other external costs	12	2857539	3283515
Expenditure on goods	13	335731	1751722
Personnel expenses (+ RD15 RD 16) of which:	14	17969517	19135100
a) Salaries	15	13868786	14523767
b) Social security costs	16	4100731	4611333
Amortization and provisions for depreciation of tangible and intangible assets	17	6434118	7553584
a.1) Expenses	18	6434118	7553584
a.2) Income	19		
Adjustment of the amount of circulating assets	20	17626	186944
b.1) Expenses	21	123515	186944
b.2) Income	22	105889	0
Other operating expenses (lines 24-26)	23	8330092	10583089
Foreign Benefit Expenses	24	6565634	8693396
Other taxes, duties and similar	25	940948	876415
Expenses with indemnifications donations and assets sold	26	823510	1013278
Adjustments for provisions for risks and charges (lines 28-29)	27	-3421	-233
- Expenses	28		
- Income	29	3421	233
Operating expenses -Total (rd 10 la 14 +17+20+23+27)	30	70002034	74369163
Operating result			
- Profit (rd 09-30)	31	7944299	8886682
- Loss (rd 30-09)	32	0	0
Income from investments	33	0	0
- Which, in the group	34	0	0
Income from other financial investments and receivables (in fixed assets)	35	0	0
- Which, in the group	36	0	0
Interest income	37	1233	1162
- Which, in the group	38	0	0
Other financial income	39	4515779	4247015
Financial income - Total (rd 33+35+37+39)	40	4517012	4248177
Adjustments of financial assets and financial investments	41		
- Expenditure	42		
- Revenue	43		
Interest charges	44	2893105	3482681
- Which, in the group	45		
Other financial charges	46	5664652	5992625
Financial expenses -Total (rd 41+44+46)	47	8557757	9475306
Financial result			
- Profit	48	0	0
- Loss	49	4040745	5227129
Current result			
- Profit	50	3903554	3659553
- Loss	51		
Exceptional Income	52		
Exceptional expenses	53		
Exceptional result			
- Profit	54	0	0
- Loss	55		0
Total income	56	82463345	87504022
Total expenses	57	78559791	83844469
- Profit	58	3903554	3659553
- Loss	59	0	0
Profit tax	60	809796	867792
Income tax	61	0	0
Net result			
- Profit (rd.58-60-61)	62	3093758	2791761