

PROFITABILITY OF THE COMPANY EXPRESSED UNDER RENTABILITY RATES

CĂRUNTU GENU ALEXANDRU

ASSOCIATE PH.D, “CONSTANTIN BRANCUSI” UNIVERSITY OF TÂRGU-JIU

e-mail: cgenuc@gmail.com

ECOBICI MIHAELA LOREDANA

LECTURER PH.D, “CONSTANTIN BRANCUSI” UNIVERSITY OF TÂRGU-JIU

e-mail: ecobici.mihaela.loredana@gmail.com

Abstract

The goal of any firm is to make enough profit to properly capitalize its capital, maintain its technical and economic potential, and ensure rational expansion taking into account market developments and short-term trends.

Two categories of indicators are used to measure profitability: profitability and profitability rates. the absolute value of profitability is reflected by profit, and the extent to which capital or use of company resources generates profit is reflected by the rate of return. as indicators of absolute profitability can be taken into account: the result of the turnover, the result of the exploitation, the financial result, the current result, the extraordinary result, the gross result of the year, the net result of the year.

The following rates are typically used for expressing relative profitability: the rate of return on trade, the rate of return on consumed resources, the rate of economic profitability and the rate of financial return.

Keywords: *the financial rule, rates of return, the size of the results, efficient management, invested capital.*

1. INTRODUCTION

Profitability is defined as the capacity of an enterprise to obtain profit, as a positive difference between the proceeds from the private activity (CA) and the costs due to manufacturing, marketing and the main transaction (costs). Profitability depends on the company's activity (the volume and the quality of the offer, the unit cost, the performance of marketing and management, etc.) and on exogenous factors, independent of the company (the level of prices formed on the market, the volume and dynamics of demand, the consumers' preferences, the competition intensity etc.). The return is appreciated under absolute aspect (as the mass of profit) and relative aspect (as a rate of return) on the product, the company and the industry sometimes. Profitability is also a form of macroeconomic efficiency which reflects the net effects (results) obtained per unit of effort (expense) with production factors. [4]

Profitability is the ability of an enterprise to achieve profit, both in terms of development and capital remuneration. The profitability analysis is based on the Profit and Loss Account

Profitability is a synthetic form of expression of economic efficiency and reflects the ability of an enterprise to achieve profit. Profitability is met when the result (accounting profit) reflects a profit, ie revenue exceeds expenditures.

Profitability can be analyzed in two ways: in terms of absolute value of profits and secondly through profitability rates (relative sizes) that link the magnitude of the results obtained with the volume of resources employed to obtain these results.

The profitability analysis must take into account the fundamental financial rule, an enterprise is profitable if the wealth of the shareholders increases.

Profitability is expressed using rates, and profitability is the relative expression of profit.

The rate of return is a relative magnitude which expresses, on the one hand, the capacity of an economic unit to make a profit, and on the other hand, the extent.

The rate of return represents a relationship between an indicator of results (profit or loss) and an indicator reflecting a workflow (net turnover, resource consumption etc.) or a “stock” (equity, total assets, etc). [15]

When we talk about profitability we must always have another component that should not be neglected, namely the risk. The profitability of the firm and the risk it involves are two fundamental concepts on which the efficiency of a business depends.

Risk analysis at the microeconomic level and particularly the economic, financial and bankruptcy risk is a constant concern of specialists in the field, these aspects are in line with all the other risks which occur in different areas of activity of the company. [6]

2. RETURN RATES - AN EXPRESSION OF THE COMPANY'S CURRENT PERFORMANCE

The rate of economic profitability measures the performance of the enterprise's total asset, regardless of how it is procured for owning the asset (own or borrowed). For this reason, it is said that the rate of economic profitability is independent of the financing policy promoted by the enterprise[3].

The rate of economic profitability has the following meanings[2]:

- measure the degree of remuneration of the company's capital;
- highlight how to use financial resources;
- measures the performance of the total asset, reflecting its economic performance.

The rate of economic profitability can be expressed in several forms, depending on how we express the effort indicator:

- rate of economic profitability of assets;
- rate of economic return on invested capital.

Economic asset rate of return (Re):

$$Re = \frac{Pb}{At} \cdot 100$$

The rate of profitability of the economic asset can also be expressed using the following model of analysis (Re):

$$Re = \frac{Pc}{Cp} \cdot 100$$

Economic Return Rate of Capital invested (Re):

$$1. Re = \frac{Pb}{K_{inv}} \cdot 100 \qquad 2. Re = \frac{Pe}{K_{inv}} \cdot 100$$

Pb = gross profit;

At = total asset;

Pc = current profit;

Cp = permanent capital;

Pe = economic profit;

K_{inv} = the invested capital.

The level of this rate is primarily concerned with current and potential investors (shareholders and banks), but also managers, for whom a high level of this rate means effective management of the capital invested [5].

In this respect, they compare the rate of economic return with the average cost of capital (RCD), and the following situations can be encountered:

a) when $R_e > R_{ci}$ means that the performed activity produces an economic profit higher than the cost of capital;

b) when $R_e < R_{ci}$ means that the profitability obtained can not meet the demands of the capital providers.

The rate of financial return (R_f) measures the performance of equity and rewards the owners of the company by granting dividends and increasing equity, being a means of stimulating participation in the increase of the share capital[7].

The rate of return on equity expresses the return on equity and allows shareholders' equity investments to be valued and the opportunity to maintain them, as a ratio between the net profit (P_n) of the firm and the equity (C_{pr}):

$$R_f = \frac{P_n}{C_{pr}} \times 100$$

Financial profitability is directly proportional to economic profitability, with the difference between the rate of economic return (R_e) and the interest rate (R_d) and the financial leverage effect. In practice, the financial return is all the greater as the difference between the rate of economic return and the interest rate is greatest:

$$R_f = \left[R_e + (R_e - R_d) \times \frac{D}{C_{pr}} \right] \times \left(1 - \frac{C_i}{100} \right)$$

D = debts;

C_i = tax rate of profit.

The leverage effect expresses the increase in the rate of return on equity due to the increase in indebtedness[8].

This model is used to substantiate the company's indebtedness and we can draw conclusions with a strong impact on shareholders, for operative management, and last but not least for creditors. In view of the above, the following conclusions can be drawn:

- if $R_e > R_d$, then $R_f > R_e$, indebtedness has a beneficial effect (levier effect), borrowed sources are used efficiently in the exploitation process, return on equity increases;

- if $R_e < R_d$, then $R_f < R_e$, leverage has a negative effect because borrowed sources do not generate effects to cover financial expenses, in which case the return on equity decreases, which raises questions for investors (the leverage effect is negative) [9].

In order to increase financial profitability, measures are needed to:

- speeding up the rotation of assets;
- increasing commercial profitability;
- Increasing economic profitability.

The rate of commercial profitability expresses the efficiency of the enterprise's business activity by ensuring the link between profit and net turnover[10].

The rate of commercial profitability expresses the efficiency of the enterprise's business activity (supply, stocking, sales) reflecting the link between total sales revenue and turnover over a given period of time. It is calculated as a ratio between an economic result (EBE, operating profit or turnover) and turnover[14].

In the literature and economic practice several ways of calculating the rate of commercial profitability are used and used, depending on the specificity of the enterprise and the purpose of the analysis, as follows:

$$Rc = \frac{P_{CA}}{CA} \cdot 100$$

$$Rc = \frac{Pe}{CA} \cdot 100$$

$$Rc = \frac{Pn}{CA} \cdot 100$$

P_{CA} = Turnover profit;

Pe = operating profits;

CA = Fiscal value;

Regardless of the method of calculation, the purpose of the analysis of these rates is to explain the evolution of this indicator and the factors that determine its evolution. An increase in the rate of commercial profitability associated with operating activities reflects a positive situation and the financial possibility of renewal of the operating equipment of the enterprise[13].

An increase in the rate of commercial profitability may occur by:

- increasing the volume of sales;
- minimizing resource consumption;
- rationalization of different categories of expenditure;
- speeding up the movement of goods;
- Increasing the productivity of the production factors (number of personnel, commercial areas, money capital);
- modernizing the technical-material base;
- intensive use of the existing technical and material base (obtaining higher results with the same funds);

The consumed resource rate, also referred to as the cost-effectiveness ratio, reflects the correlation between the turnover profit and the total cost of sales. According to many specialists, the consumption rate should be between 9% and 15%.

By definition, the rate of return on consumed resources reflects the relationship between the result of the turnover and the total costs of the sales[12].

The rate of return on consumed resources is expressed as the ratio between a certain economic result and the expenses incurred to obtain it. It is of interest to business managers, who need to make efficient use of available resources. Thus, we can consider the rate of return on turnover related expenses:

$$Rrc = \frac{P_{CA}}{Ch_{CA}} \cdot 100$$

Ch_{CA} = turnover related expenses.

It follows from this relationship that the change in the rate of consumed resources is directly explained by the change in the structure of the production sold, product costs and sales prices excluding VAT by product category [11].

Increasing the profitability rate of consumed resources can take place through:

- improving the structure of the products sold;
- Cost reduction per unit of product;
- Increasing sales prices.

The consumed resources rate of return is expressed as a ratio between a certain economic result and the expenses performed for it. It is important to the business managers who need to make efficient use of the available resources. Thus, we consider the following rates: [1]

1. the return on operating expenses that can be determined as a ratio between the gross operating surplus and the difference between operating expenses, amortization expenses and operating expense provisions (Ce-A-Cpe).

2. the return on expenses related to turnover determined as a ratio between profits related to turnover and total costs. Based on this computation method it results that the change in the consumed resources rate of return is explained directly by the change in the structure of production sold, cost of goods and selling prices without VAT on products categories.

3. CONCLUSIONS

Profitable economic activities based on the principles of profitability and efficiency must end with a surplus of financial resources in relation to the amount of resources consumed for their performance. This surplus of financial resources may have, in the first instance, only economic content without monetary correspondence. When the surplus of financial resources also benefits from a monetary plan, it becomes a monetary surplus and can serve various financing needs of the enterprise.

Information about an enterprise's performance, especially its profitability, is useful in assessing potential changes in the economic resources that the enterprise will be able to control in the future and anticipating the ability to generate cash flows with existing resources.

Most of these economic and financial indicators are calculated on the basis of information provided by companies in the financial statements. The usefulness of these economic and financial indicators consists in highlighting a trend, especially in the possibility that the analyzed company can be compared with other companies active in the same sector.

In order for the profitability analysis to be valued by the company's management, we need to analyze past performance, set clear goals and strategies for the company's development direction, allocate the necessary resources, and constantly track the results. Depending on the results of these analyzes, specific goals, strategies and business policies will be set to maximize sales and trade margins.

The aforementioned information, with commercial and financial content, must be in the form of periodic managerial reports, which will lead to the development of a useful scoreboard for general business management. These internal reports required by the management team are developed by internal or external collaborators of the firm and are based on the registration, processing and systematization of data according to the internal business management needs.

REFERENCES

- [1] **Bușe Lucian**, Analiză economico-financiară, Ed. Economică, București, 2005;
- [2] **Caruntu G. A., Holt Ghe.**- Financial Accounting Management, Scrisul Romanesc Pub., Craiova, 2014;
- [3] **Cenar I, Diaconu S. C.** – The account life of the firm from establishing to bankruptcy, CECCAR Publishing House, Bucharest, 2006;
- [4] **Dobrotă Niță**, Dicționar de economie, Ed. Economică, București, 1999;
- [5] **Dragotă V., Ciobanu A., Obreja L., Dragotă M.**, - Financial Management, vol I, Financial analysis and operational financial management, Economica Pub., Bucharest, 2003;
- [6] **Lăpăduși Mihaela Loredana, Florea Ianc Maria Mirabela**, Analysis of the influence of a company's indebtedness on the financial risk, Annals of the „Constantin Brâncuși” University of Târgu Jiu, Economy Series, Special Issue/2015, pag. 193-200, http://www.utgjiu.ro/revista/ec/pdf/2015-03%20Special/33_Lapadusi.pdf

- [7] **Niculescu M.** - Global Strategic Diagnostics, Vol. I and II, Economica Pub., Bucharest, 2003;
- [8] **Patrascu L.** – Financial Statements - Information support in management decision, Tehnopress Pub., Iasi, 2008;
- [9] **Pavaloaia W, Paraschivescu M.D., Olaru D., Radu Fl.**- Financial analysis. Case studies, Tehnopress Pub., Iasi, 2006;
- [10] **Pirtea M., Cristea H., Nicolescu C., Boțoc C.** – Financial management of the company, Mirton Pub., Timisoara, 2010;
- [11] **Petrescu S.,** - Accounting analysis and diagnosis. Theoretical and applied guide, 2nd edition, CECCAR Pub., Bucharest, 2008;
- [12] **Popa (Lezeu) D., Mester C.** - Economic and financial analysis: elements of theoretical and practical applications, University Pub., Oradea, 2006;
- [13] **Popescu V.L., Nistor C.Gh., Caruntu G.A.** – Financial management of enterprise and mathematical applications in economics, Sitech Pub., Craiova, 2007.
- [14] **Serban C.** - The risk in the activity of economic agents, Tribuna Economica Pub., Bucharest, 2009;
- [15] **Vâlceanu Gheorghe, Robu Vasile, Georgescu Nicolae,** Analiză economico-financiară, Ed. Economică, București, 2005.