

ANALYSIS OF THE PROFITABILITY - FINANCIAL POSITION CORRELATION

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Abstract

Evaluating a business' financial performance and profitability is a fundamental element of financial management, having a considerable impact on long-term success. In today's context, it is essential for a manager to be well informed about the current state of the business and to be able to react promptly to changes that could negatively influence its value, thus diminishing returns for investors, even in the absence of a financial crisis .

The main objective of this topic is to apply financial analysis methods to identify the performance and financial health of the analyzed company, based on profitability rates and financial indicators that reflect its position. In addition, recommendations will be made to improve the current situation. To achieve this goal, the paper will use the methods of description, analysis, comparison and synthesis. .

Economic-financial analysis plays an essential role in understanding the current context and in ensuring favorable results in the future. The evaluation of financial statements is fundamental to carry out a complete diagnosis of the profitability and financial stability of a company, representing a basic element in the analysis of financial performance. Performance refers to the realization of activities that require specific skills. In the case of an organization, it reflects the ability to achieve set goals. In certain circumstances, it may be necessary to temporarily abandon the principles of economic rationality in order to access new markets or maintain existing products. This forgoing of short-term profit should lead to higher future profits. Profitability assessment involves calculating the difference between income and resources consumed, with the aim of increasing the wealth of the owners by distributing dividends or increasing equity.

Keywords: analysis, performance, position, profitability

1. Introduction

Performance is a concept frequently encountered by managers, defined as the ability to perform an activity in a certain unit of time. It can also be perceived as a trait that compares the performance of an activity to a reference standard. Being a subjective concept, performance varies between different companies and is essential for achieving the objectives of shareholders, customers and other stakeholders of the organization [6].

Performance can be examined from multiple angles: owners can evaluate the efficiency of invested capital, customers benefit from the services offered, and creditors analyze the ability to meet financial obligations. However, performance evaluation and management are critical to the company's future success. The distinctions between the individual performance concepts are manifested in the evaluation methods, which will be detailed in what follows.

Performance evaluation has gradually evolved over time, moving from traditional indicators such as measuring profit margin and profit growth to evaluating profitability and using modern methods focused on value creation. Since the 20th century, the approach to business performance evaluation has been closely related to the investment evaluation method.

Contemporary methods of evaluating the performance of a business focus on the generation of value beyond the capital invested by the owners. Unlike the traditional profit approach, current methods emphasize economic profit, which also takes into account the opportunity costs of capital, taking into account the risks associated with the business and the opportunity costs.

2. Objective and approach for performing financial analysis

Financial analysis is an essential tool for evaluating a company's performance and financial condition. This consists of a systematic examination of data, mainly from financial statements, with the aim of evaluating both the company's past and present, as well as future financial prospects [8].

The objective and approach of financial analysis can differ significantly depending on its users, who often have distinct interests. These users are presented in figure no. 1.

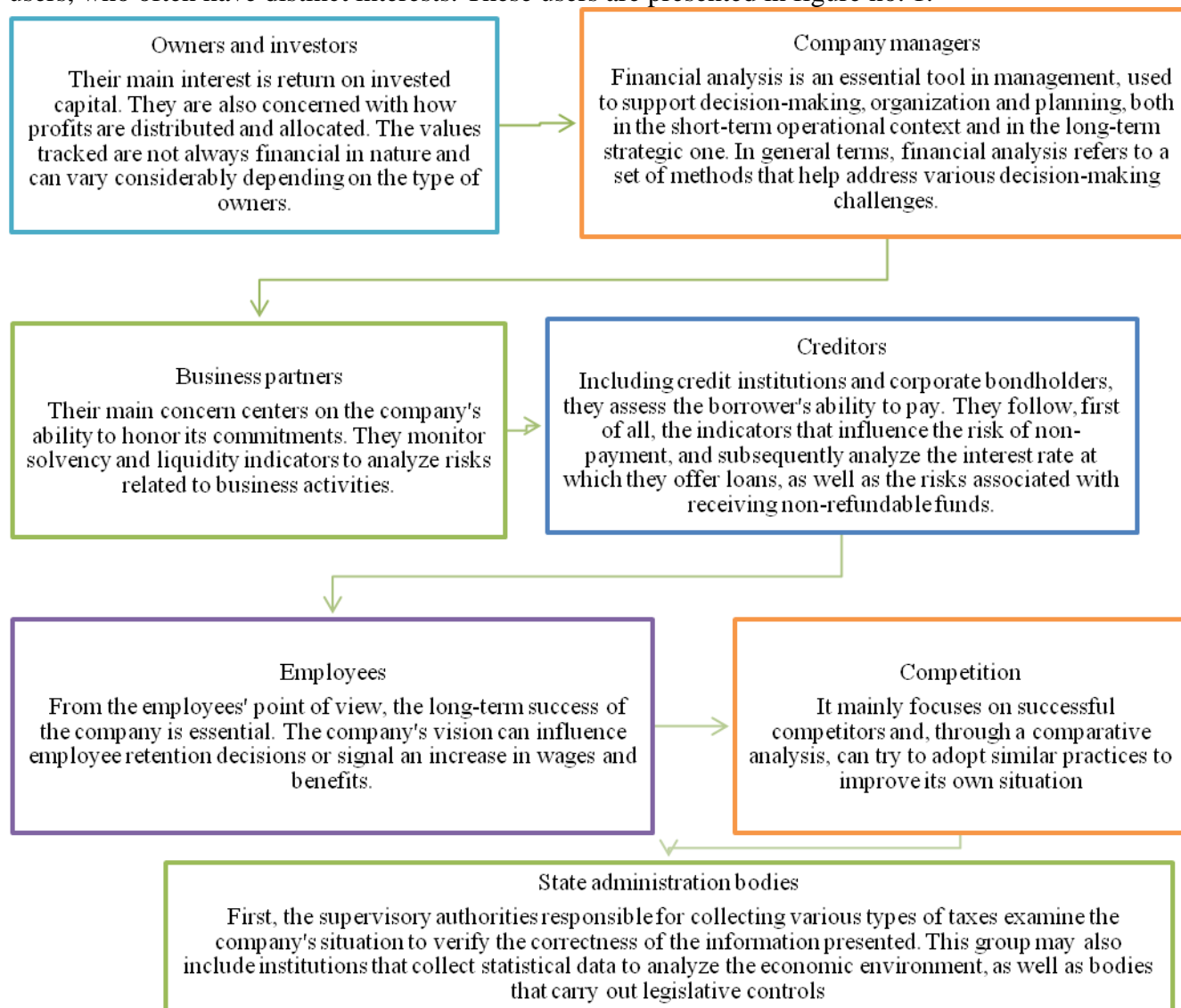


Figure 1 Users of financial analysis [8]

The aforementioned groups mainly focus on financial analysis from a quantitative perspective. However, there are many other interest groups that may be more concerned with the qualitative aspects of the company, be it the general public or non-profit organizations. These may include topics such as environmental sustainability or the social dimensions of the company's activity.

The quality of financial analysis depends on the accessibility of information, both in terms of quality and quantity. The information falls into two categories: internal, related to a specific company but often incomplete, and external, which includes data about the economic and sectoral context. Internal information may come from management accounting and financial statements,

while external information provides insights into the industry and economy in which the company operates.

Profitability and efficiency are crucial to the survival of a business because they influence profitability. Owners and managers must carefully evaluate these aspects in planning strategies and analyzing results. The economic-financial analysis uses specific indicators to evaluate the company's activity, offering a valuable tool for formulating conclusions [9].

From an economic perspective, profitability represents the ability of a company to obtain profit, resulting from the performance of profitable economic activities, which highlights the efficient functioning of the enterprise system.

Evaluating an activity cannot be done solely on the basis of absolute profit, as rates of return may indicate unprofitable aspects. It is essential that any economic activity demonstrates an increase in economic effects clearly superior to the efforts made, thus respecting the principle of economic efficiency.

Establishing the causes that generate the problem and the effects that the factual situations have or can have for each type of problem. Essential in this phase is understanding the nature of the causes that generated the positive and negative symptoms. The causes can be direct, indirect, main / secondary. The effects can be immediate, medium or long term. [11]

In conclusion, profit is an essential indicator of a firm's performance, presented as gross or net profit. However, the assessment of economic efficiency should not be based on profit alone, as some firms may generate profit without reflecting the effort expended. Profitability, on the other hand, provides a synthetic measure of the efficiency of the company's economic activity, highlighting the efficient use of resources and labor in all stages of the economic process.

3. Correlation coefficients

Profitability ratios are financial ratios that evaluate a company's ability to generate profit relative to revenues, costs, assets, or equity. They are essential in financial analysis, providing an overview of the performance and financial health of a business. Profitability ratios are more useful in comparisons than when analyzed in isolation and can be correlated with efficiency ratios, which measure the use of internal assets to generate revenue.

Profitability ratios provide a clear picture of how a company's management is managing the business, useful for investors in evaluating a firm's investment potential. High profitability ratios can highlight a company's competitive strengths and advantages, such as the ability to set higher (or lower) prices for its products and keep costs low.

Comparing a company's profitability ratios to those of similar firms and analyzing historical performance can provide useful information about profitability. An increase in value over the previous period suggests a profitable firm. Rates of return measure returns on investments, reflecting the efficiency of their management to create value for investors, being classified into margin ratios and profitability ratios.

Margin ratios provide a variety of perspectives, allowing a company's ability to convert revenue into profit to be evaluated from different points of view. In contrast, rates of return provide various methods of measuring how efficiently a company produces profit for its shareholders using invested capital. Here are some common examples of these two types of profitability ratios, see figure 2.

Various profit margins such as gross margin, operating margin, pre-tax margin and net profit margin are used to assess the profitability of a company based on survey costs. Cost reduction magnifies the difference between profit and cost, while additional expenses such as cost of goods sold, operating expenses, and taxes diminish them. These indicators are crucial for the analysis of the company's profitability and financial situation [9].

Margin rates are calculated by relating margins to turnover, highlighting revenues from operational activity. These are also known as commercial rates of return, and the most relevant of them are listed.

- rate of profit margin (REBITDA)
- net operating profit rate (REBIT)
- net margin rate (RPN)
- gross self-financing margin rate (RCAF)

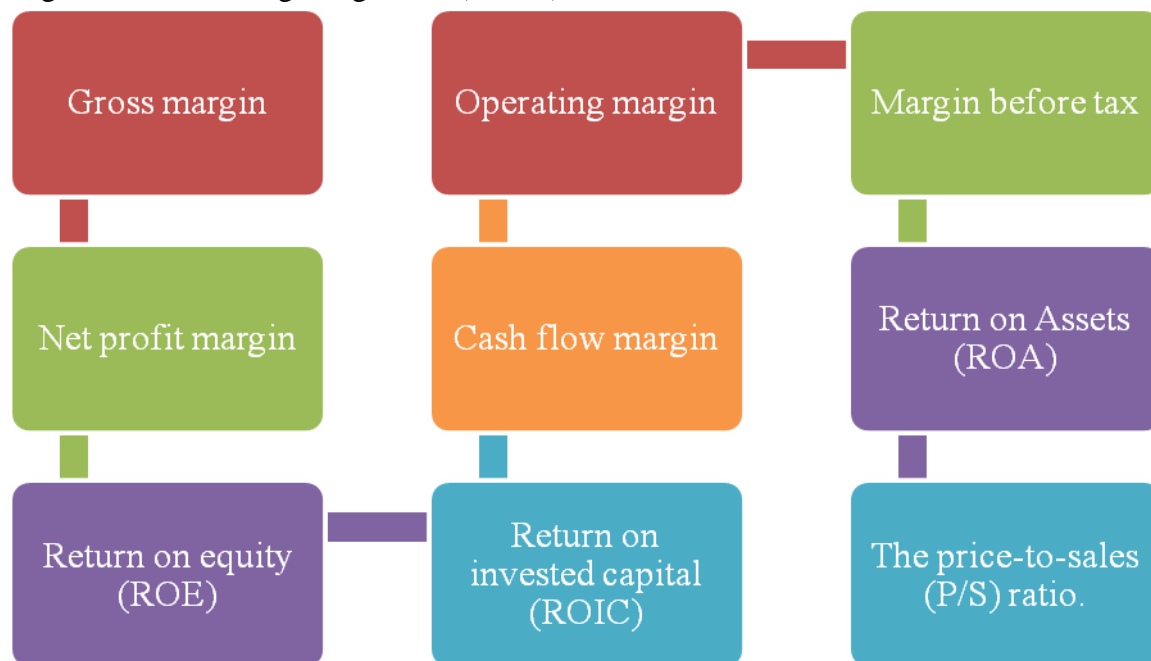


Figure 2 Examples of profitability rates [3]

Turnover ratios, calculated on the basis of the profit and loss account and correlated with the balance sheet, indicate the return on capital and the utilization of the company's assets. These can be expressed by the speed of rotation or by the duration of rotation.

Rates of return measure a firm's efficiency in using assets and managing opportunities, including return on assets, asset utilization rate, return on capital employed, financial return, and interest rate. They constitute a complex method of evaluating the economic efficiency of a company, emphasizing its ability to generate profit [7].

Rates of return are key indicators in finance that measure a firm's efficiency in using assets and managing opportunities over the course of a year. These include: commercial rate of return, economic rate of return (divided into gross economic rate of return and rate of return on capital invested), financial rate of return, net profit rate, gross profit rate and rate of return on resources consumed.

4. The rates of return and the financial position of the firm

In this section, the indicators mentioned in the first chapter will be examined in order to emphasize the link between profitability and the financial situation of company X.

Profit margin rate – Financial management of the company X S.R.L. is considered efficient, having high profit rate values. In 2021, this rate was below 50%, indicating a higher cost of operation compared to sales. The profit ratio is an important indicator for evaluating the firm in price negotiations and reflects financial performance, providing the manager with useful information for strategic decisions. Also, the net operating margin rate cannot be calculated due to the lack of depreciation expense, and the data is similar to that of the profit margin rate.

Net margin rate – This indicator reflects the ability of the company X S.R.L. to achieve profit in relation to total sales, measured by turnover. The trend of the rate is fluctuating: initially, it increases from 42.11% in 2021 to 73.72% in 2022, but due to a decrease in profit, the rate decreases to 58.03% in 2023.

Table 1 Indicators from the balance sheet for calculating the profit margin at X S.R.L. (lei)

Nr.crt.	INDICATOR	2021	2022	2023
1	EBITDA (2+3+4+5)	53.836	123.063	87.988
2	Net profit	48.942	111.876	79.989
3	Interest expense	0	0	0
4	Tax expenses	4.894	11.187	7.999
5	Depreciation expenses	0	0	0
6	Turnover	116.224	151.751	137.836
7	Profit margin ratio (1/6) $R_{EBITA} = \frac{EBITDA}{CA} \times 100$	46,32%	81,09%	63,83%
8	Net Margin Rate (2/6) $R_{PN} = \frac{PN}{CA}$	42,11%	73,72%	58,03%
9	Self-financing capacity (2+10)	68.519	156.626	119.984
10	Depreciation	19.577	44.750	31.996
11	Self-financing gross margin rate (9/6) $R_{CAF} = \frac{CAF}{CA}$	58,95%	103,21%	87,04%

Source: the data are taken from the company's financial documents

Self-financing gross margin rate - To determine the self-financing capacity, it is essential to calculate the depreciation, which represents 40% of the net profit of the company X S.R.L.

The self-financing gross margin rate increased from 58.95% in 2021 to 103.21% in 2022, but subsequently decreased to 87.04%. This decrease is due to the increase in expenses, which led to a reduction in the company's profit.

➤ **Turnover rates – see table 2**

Table 2 Balance sheet indicators for calculating turnover rates at X S.R.L. (lei)

Nr.crt.	INDICATOR	2021	2022	2023
1	Turnover	116.224	151.751	137.836
2	Current asset	118.646	204.431	130.833
3	Rotation speed (1/2) = Turnover/ Current asset	97,95	74,23	105,35
4	Rotation Duration (2/1) = (Current asset/Turnover) x360	365,7	484,97	341,7

Source: the data are taken from the company's financial documents

Turnover speed - According to the information provided, the current assets turnover speed was 98 days in 2021, 74 days in 2022 and 105 days in 2023. These calculations highlight the degree of utilization of the assets of the company X S.R.L.

The duration of rotation - The efficiency of the asset within the company is influenced by the fact that the company has not registered fixed assets, so this indicator refers exclusively to current assets. The number of days increased by 117 between 2021 and 2022, but subsequently decreased significantly, reaching 342 days, which is the lowest value in the analyzed period.

➤ **Rates of return**

Asset ratio - The company has the ability to generate profit, an aspect that is reflected in the accounting documents at the end of the financial years. The growth rate is on the rise, which indicates that the firm's capital has been effectively utilized in current assets.

Table 3 Balance sheet indicators for calculating rates of return at X S.R.L. (lei)

Nr.crt.	INDICATOR	2021	2022	2023
1	Net profit	48.942	111.876	79.989
2	Total active	118.646	204.431	130.833
3	Return on assets (1/2) = Net profit / Total active	41.25%	54.72%	61.13%
4	Total revenue	139.149	189.016	138.077
5	Asset Utilization Rate (4/2) = (Total revenue/ Total active)x100	117,28%	92.45%	105,53%
6	Own capital	110.770	201.593	80.229
7	Financial return (1/6) = Net profit / Own capital	44,18%	55,49%	99,7
8	The gross result	49.727	112.691	81.367
9	Turnover	116.224	151.751	137.836
10	Rentabilitatea comercială (8/9) = (The gross result/ Turnover)x100	42,78%	74,26%	59,03%
11	Gross economic return (7/2) = (Financial return/ Total active)100	41,91%	55,12%	52,19
12	Return on net profit (1/4) = Net profit/ Total revenue	35,17%	59,18%	57,93
13	Gross profit rate 8/4 = The gross result / Total revenue	35,73%	59,61%	58,92%
14	Total expenses	89.422	76.325	56.710
15	Return on resources consumed (8/14) = (The gross result / Total expenses)x100	55,6%	147,64%	143,47%

Source: the data are taken from the company's financial documents

Asset Utilization Ratio - The company's assets are being used in a very efficient manner, as the ratio values indicate that the company is generating profit every year. The return on invested capital cannot be determined, because the company X S.R.L. it has no interest, and the results would be similar to those of the asset ratio indicator.

Financial return - The upward trend of financial return illustrates the ability of X S.R.L. to generate income from the use of available equity, which contributes to shareholder satisfaction. Thus, the high levels of financial profitability indicate that X S.R.L. can distribute dividends to shareholders and increase reserves when seeking to improve the financial position of capital owners.

Commercial Profitability - Considering that the values are considerable, a suitable commercial margin is noted, which makes the expenses not very strict and the services provided by the company do not require high costs. Although 2023 saw a decrease in profitability, the company strengthened its position in the sales market.

Gross economic return - The trend of gross commercial return was an upward one. In 2021, the value was 41.91%, and within 12 months it increased by about 14 percentage points. In 2023, the increase was more modest, of only 4 percentage points, thus reaching 59.03%.

Net Profit Rate - The data presented indicates an increase in profit in 2022 compared to 2023, despite the fact that in 2023 profit decreased by 28.5% compared to the previous year. However, this decline was less than that of total revenues, which was 26.94%. As a result, the rate of return decreased by approximately 2 percentage points from 2022, from 59.18% to 57.93%. However, the values obtained during the analyzed period suggest a healthy and profitable financial situation, thus conferring a favorable position on the sales market.

Gross profit ratio - Given that the difference between gross and net profit is very small, and the value of the ratios is also low, being sub-unit over the entire period of analysis. The increase in the rate indicates that the company X S.R.L. is ready to capitalize on the market and intends to charge higher prices for the services offered. However, in 2023, the decrease in the rate suggests that new competitors have appeared in the market, which has forced the company to maintain existing costs or reduce them in certain service segments. Also, a possible increase in raw material prices contributed to the decrease in the rate in 2023 compared to 2022.

Return on resources consumed - the drop in rate in 2023 was driven by a decrease in net profit over the same period. However, in the long term, the trend is a positive one, considering that the rate has increased in the last three years under review. This evolution is due to the beneficial influence of the structure of the services offered and the associated costs, a situation that was possibly also influenced by the favorable conditions on the outlet market, as well as by the increase in consumer demand. The removal of the restrictions imposed by the Covid-19 pandemic led customers to return to the company's services, resuming the activities from before 2019.

In conclusion, profitability ratios are essential to assess whether the company X S.R.L. has the ability to generate sufficient profits to grow in the market. They allow him to maintain or improve his position, as well as to ensure the company's remuneration.

5. Conclusions

Profitability indicators are used by analysts and investors to evaluate the ability of the company X S.R.L. to generate income and profit in relation to various financial aspects. They reflect the efficiency of using assets to create profit and shareholder value. The firm aims to obtain higher values of these indicators, which suggests a good business operation. The analysis of indicators becomes more relevant by comparing them with those of competitors or with previous periods.

Company XS.R.L. aims to achieve higher profit than costs, with efficiency, resource management and strategic decisions as essential factors. Profitability is a key indicator of business success and health, and profitability reflects the company's ability to generate revenue that exceeds operating expenses and costs.

Profitability is essential to the operation of X S.R.L., which must have higher revenues than expenses. To remain profitable and competitive, the company must constantly monitor and adjust its operations. Performance evaluation is done through the formula of profitability ratios, which analyze revenues, expenses and other relevant factors to determine the efficiency of the firm.

In order to ensure the future of the X S.R.L. company, it is recommended to quickly adopt an effective risk management strategy, evaluate the activity and make forecasts. It is necessary to establish an internal control system to collect accurate information to be used in data analysis and risk management plans. The risk review will be essential for the evaluation of the financial results obtained following the implementation of the strategic measures.

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