EVALUATION OF A COMPANY BY PROFITABILITY

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Abstract: Evaluation of a company refers to process of obtaining and estimating the knowledge related to appreciation of the state of the company itself, as are methods, techniques and instruments of diagnosis and evaluation, getting use to handle some synthetic practices regarding company activity and to elaborate an estimating report. The economic and financial estimation of a company is based on its balance-sheet and on expert’s report and diagnosis, and it must be carry out systematically, for a good business administration its objectives being in fact, determination of market value of its goods and of the company. The economic efficiently is a modern concept of evaluation the activity and it is used decisions making process, so the available resources to be used in the most favourable manner for the company. The profitability is a synthetic way of expressing the economic-financial activity efficiency of the company, respectively of the entire production factors and, in the same time, the labour, during all economic process stages: supply, production and trade.

INTRODUCTION

Evaluation can be defined as being an ensemble of techniques, procedures and methods used for determining the value of a good, of a group of goods, of an asset or of the entire company.

Evaluation of a company refers to process of obtaining and estimating the knowledge related to appreciation of the state of the company itself, as are methods, techniques and instruments of diagnosis and evaluation, getting use to handle some synthetic practices regarding company activity and to elaborate an estimating report.

Depending on the purpose of the evaluation can be distinguished: accounting evaluation, managerial evaluation and economic evaluation.

The difference between accounting and economic evaluation consists in the fact that the last one take into consideration some influence factors which are not entirely reflected into accounting: exchange rate, price evolution, real depreciation of goods, intern administration of each company and real utility of the goods. The most important cases when the economic evaluation is used are: if there are transformation in size of equity capital or in number and configuration of shareholders or partners, in case of some particular commercial transaction when both the seller and the buyer wish company estimation, the assets or goods evaluation on the market; in case of patrimonial juridical action as are: successions, separations, fusions, liquidations, bankruptcies; in case of entering on stock exchange, and continuously after that using, generally, stock exchange methods.

The beneficiaries of evaluation work can be institutes and public organizations, banks, creditors, stock exchanges, investments funds, the firms, individuals, court of justice, fiscal organizations etc.
The evaluators can be either members of ANEVAR (the National Association of Evaluators from Romania) or members of CECCAR (Then Body of Authorize Accounting Experts from Romania) or evaluation experts and specialized company unaffiliated to any professional association. After the evaluation, the evaluators recommend the value.

MATERIALS AND METHODS

The economic and financial estimation of a company is based on its balance-sheet and on expert’s report and diagnosis, and it must be carry out systematically, for a good business administration its objectives being in fact, determination of market value of its goods and of the company. The diagnosis of company refers to the necessity of finding general information about a company and its background, and can be: juridical diagnosis, human potential diagnosis, technical potential diagnosis, commercial potential diagnosis and financial diagnosis. Any of these diagnoses acquire specific objectives.

Depending of the evaluation method used be observed a few types of evaluation: statistic estimating, dynamic evaluation (profitability), evaluation based on market comparison, or the cash-flow, stock exchange method of evaluation, goodwill methods, mix methods (which approach both the patrimony and the profitability), and other methods of evaluation used in specific cases. The use one of these evaluation methods depends on the ascertainties of the evaluation diagnosis.

Brilman and Gautier (1976) consider that there are three mains axis of evaluation a company:

- Profitability;
- Net asset (the patrimony);
- Turnover.

If we are referring to profitability, we can take into consideration more distinguished approaches or only one of them:

- analyze of rentability using profit rate analysis;
- analyze of rentability using rentability rate analysis;
- analyze of rentability using the breakeven point analysis.

On the same time, the profitability concept can not be separated by the concept of risk, rentability presumes risk; nothing is sure in a company activity. And the best example in this context is the economic risk. Nevertheless, rentability varies on different cases (for instance in case of salary rise or raw material costs increase), on share of fixed expenses (from here rise the interest for breakeven point analysis), on the need of working capital fluctuation in terms of sales volume variation (treasury can be perturbed, in that case).

As a study case, it was performed the rentability analyze based on the rentability rates. That expresses the efficiency of using the technical and financial resources on operating activity at the company level in the analyzed period.

There were used a few hypothetical balance-sheet data at the end of the years 2005, 2006, 2007. The level of the rentability rates is can be seen in the table below:
The analyze of profitability based on profitability rates

<table>
<thead>
<tr>
<th>Lei-crt.</th>
<th>Specification</th>
<th>Symbol</th>
<th>Year 2005</th>
<th>Year 2006</th>
<th>Year 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Operating revenues</td>
<td>Ve</td>
<td>24,608</td>
<td>39,741</td>
<td>58,426</td>
</tr>
<tr>
<td>2</td>
<td>Operating expenses</td>
<td>Che</td>
<td>21,364</td>
<td>33,741</td>
<td>49,121</td>
</tr>
<tr>
<td>3</td>
<td>Operating profit (result)</td>
<td>Pe = Ve – Che</td>
<td>3,244</td>
<td>6,000</td>
<td>9,304</td>
</tr>
<tr>
<td>4</td>
<td>Current profit (result)</td>
<td>Pc</td>
<td>3,218</td>
<td>7,804</td>
<td>9,816</td>
</tr>
<tr>
<td>5</td>
<td>Net profit (result)</td>
<td>Pn</td>
<td>1,802</td>
<td>4,680</td>
<td>7,467</td>
</tr>
<tr>
<td>6</td>
<td>Own capital</td>
<td>Cpr</td>
<td>19,620</td>
<td>31,049</td>
<td>45,161</td>
</tr>
<tr>
<td>7</td>
<td>Total asset</td>
<td>At</td>
<td>27,167</td>
<td>52,566</td>
<td>76,521</td>
</tr>
<tr>
<td>8</td>
<td>Revenues profitability rate</td>
<td>Rv = Pe / Ve</td>
<td>13.18%</td>
<td>15.09%</td>
<td>15.93%</td>
</tr>
<tr>
<td>9</td>
<td>Expenses profitability rate</td>
<td>Rc = Pe / Che</td>
<td>15.18%</td>
<td>17.78%</td>
<td>18.94%</td>
</tr>
<tr>
<td>10</td>
<td>Economic profitability</td>
<td>Re = Pe / At</td>
<td>11.94%</td>
<td>11.41%</td>
<td>12.16%</td>
</tr>
<tr>
<td>11</td>
<td>Financial profitability</td>
<td>Rf = Pc / Cpr</td>
<td>16.40%</td>
<td>25.13%</td>
<td>21.73%</td>
</tr>
</tbody>
</table>

Source: company internal data (hypothetical balance-sheet data)

RESULTS AND DISCUSSIONS

The rentability rate represents a relation between a form of a profit express and assets or a capitals (own capitals, permanent capitals), or an activity flow (turnover, used resources).

Economic rentability measures the resources performance used in the operating process, without taking into consideration the financial mechanism (the provenience of financial sources), extraordinary result and fiscal occurrence (profit tax).

Financial rentability measures the resources performance used in the operating process, taking into consideration the financial policy of the company.

The revenues rentability represents a relation between the operating profit and total operating revenues.

The used resources rentability represents a relation between operating profit and total operating expenses of the analyzed company.

Operating profit (result) (Pe) measures, in absolute measures, the profitability of the operating process, by deduction all expenditures from the operating revenues. The increase trend of the indicator points out the process of rentability of the operating activity based on another realized operating revenues, too.

Current profit (result) (Pc) is determined by operating result and by financial activity. In the analyzed period the financial exercises were closed with profit, fact that positively affects the current result of exercise.

Net profit (result) (Pn) represents, in absolute measures, the level of financial rentability of shareholders own subscribed and paid up capital. This indicator knew a growth in the analysed period, because of:
- the production growth during the exercise;
- the operating subsidies allocation;
- the other operating revenues growth.
The analyze of profitableness rates

During the analysed period (2005-2007) the level of rentability rates were satisfactory.

- **The rentability of revenues** shows the efficiency of commercialisation of the products and services of the company. The indicator registers a continuous growth in the working period, but quite limited.

- **The rentability of costs** measures the profitability of human and materials resources use; it registers almost the same evolution as the revenues rentability rate.

- **Economic rentability** represents the gross payment of invested capital on long term both own and borrowed. The economic rentability reaches the level of minimum rate of efficiency on economy (average rate of interest) and of the economic and financial risk assumed by company shareholders and creditors. The economic rentability rate registers a relatively constant level in analysed period, having the values above the average rate of interest (which was 9.59% in 2005, 8.43% in 2006, and 8.13% in 2007). From the above figure it can observed that the economic rentability rate knows a little decrease in the year 2006, comparing with the year 2005 (of 0.53%), and in the year 2007 it growths higher than the decrease, with 0.75%. This rate reveals how much the operating result is enough for to financing the need of current and fixed assets of operating process.

- **Financial rentability** measures the efficiency of own capital use. The financial rentability rate must be higher than the average rate of interest. This indicator shows how much lei remain after every hundred lei invested from the total own capital. It can be observed, from the figure, that the financial profitability rate had a fluctuated evolution during the analysed period. So, if in the year 2005 the value of this rate was 16.40% (much higher the average rate of interest which was about 9.59%), it increased in the year 2006 with 10%, achieving the level of 25.13%, while in the average rate of interest decreased, too, in the year 2006 to 8.43%. In the year 2007, financial rentability rate decreases comparing with the previous year with 3.4%, being, anyway, much higher the average rate of interest (8.13%). The evolution of this rate was a result of the increase of own capital year by year (by continuous development of the company, of production activity, of new investments which generated the increase of the profit and of subsidies received), but, in the same time, of the current profit increase, which doubled comparing with the year 2005 (that explaining the increase of financial rentability rate in the year 2006, too). Also, in the year

![Figure 1](image-url)
2007, the current profit increase but in a less accentuated rhythm than the previous year, fact that explain the decrease of this rate with 3.4% comparing of the previous year.

CONCLUSIONS

Study of profitability of one operation, activity or one company is always attended by the satisfaction related as reward of the effort. Elie Cohen (manager of research at the National Centre of Scientific Research from France) presents rentability as a technical approach of the performance, a definition that includes both the common aspects and the differences between the two above presented concepts. The result and, in the same time, rentability, is an absolute measure, while the performance is a relatively concept based on objectives and rules. The result is a well-defined performance or a part of a performance, having specific nature. The rentability can be defined as being the capacity of a company to gain profit using production factors and capitals regardless of their provenience. We can talk about profit only when the revenues are bigger than the expenses; the profit is only a part of the rentability. And, for describing a company in terms of profitability, for seeing if a company is or is not efficient, we consider that must be studied three keys aspects:

- activity evolution (the increase, decrease of economic activity);
- turnover evolution, the added value evolution;
- rentability itself evolution (the profit, rate of rentability – as indices).

Any company must assure the payment and the renewal of invested capital, ant that fact is realised only in case of a sufficient rentability of its activity.

REFERENCES