

THE RELEVANCE OF THE FINANCIAL DIAGNOSIS ON THE DECISION-MAKING PROCESS

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Abstract: *The accounting's main objective is to offer in financial terms an accurate image of a company's activity, while the financial management is focused on administrating the information delivered by the accounting in order to make the most appropriate decisions in order to accomplish the fundamental objective of a company, namely the profit. By using a various research methodology, such as: the data analysis, the case study or the dynamic and comparative study, the present paper aims to emphasize how important the financial diagnosis is, in order to improve and to optimize the decision-making process within a company. In order to increase the relevance of the results, it was taken into consideration a stock listed company.*

Key words: *financial diagnosis, indicators, relevance, decision-making process*

INTRODUCTION

In order to appreciate the financial health of a company, the first step is a diagnostic analysis aimed to outline the perimeter quite limited of the entity in the approach of outlining and implementing of the strategies for conservation and development.

The rates system represents, in addition to the absolute indicators of financial structures confined within the financial statements, a basic tool in diagnosing the entity's financial state [4].

This is based on the philosophy of the flow indicators correlation (taken out from the profit and loss account or the financing statement) with the stock indicators (taken out from the balance sheet). While the stock indicators merely reflect the fair image of the entity in cumulative figures, the flow indicators come to the aid of the analysts, providing information of the „moment” on the formation of cumulative figures shown by the stock indicators [1].

MATERIALS AND METHODS

In order to elaborate this paper, various research methods are used, such as: the analysis, the synthesis, the induction, the deduction, the brainstorming, the dynamic study or the case study [13].

RESEARCH RESULTS

Under this financial picture, we find that the assets of a certain stock exchange listed entity, namely Petrom, represents a large proportion of tangible fixed assets representing wells, infrastructure, plant and machinery for oil extraction.

The share of tangible fixed assets revolves on average around 75%, of which approximately 65% represents wells, equipments and facilities for extraction. There cannot be neglected the property rights of the entity or the entity's financial activity. In this regard, we will notice that Petrom has established a diversified portfolio of financial titles, which, in the second period analyzed, namely N-4 - N-2, while increasing purchases on the capital market, records a growing profit at the level of financial activity. Moreover, the state provides real support to the entity, by increasing decommissioning costs that Petrom recovers from the state. In what follows, we present, in a schematic manner, a dynamic analysis of the synthesis accounting information of our entity, bringing to the fore:

structural indicators, indicators of funding, management indicators, profitability indicators, risk indicators or cost indicators (Table 1) [14]:

Table 1.

Various indicators of a listed company for a five years time period

Objective	Indicator	N-4	N-3	N-2	N-1	N
Investments	Fixed assets	0.598	0.676	0.777	0.796	0.834
	Intangible assets	0.007	0.012	0.019	0.057	0.044
	Tangible assets	0.709	0.642	0.645	0.689	0.712
	Financial assets	0.284	0.346	0.336	0.254	0.244
	Current assets	0.402	0.324	0.223	0.204	0.166
	Stocks	0.208	0.233	0.410	0.471	0.475
	Receivables	0.161	0.217	0.430	0.335	0.461
	Liquidity	0.631	0.550	0.160	0.051	0.063
Funding	Global autonomy	0.826	0.844	0.835	0.733	0.688
	Overall indebtedness	0.174	0.156	0.165	0.267	0.312
	Financial stability	0.828	0.845	0.837	0.814	0.826
	Financial indebtedness	0.997	0.998	0.998	0.900	0.833
	Repayment capacity	0.960	0.734	0.906	0.848	1.284
	Financial balance rate	0.521	0.538	0.737	0.862	0.753
Management	Receivables rotation	38.90 days	37.98 days	59.89 days	37.13 days	57.86 days
	Stock rotation	50.34 days	40.89 days	57.12 days	52.17 days	59.63 days
	Commercial credits rotation	25.66 days	33.16 days	52.32 days	48.61 days	55.51 days
Profitability	Commercial profitability	91.25%	96.44%	18.96%	8.39%	16.70%
	Economic profitability	33.76%	35.39%	31.77%	33.50%	24.09%
	Financial profitability	13.20%	18.54%	13.49%	7.53%	9.73%
Risk	Current liquidity	3.196	2.781	1.818	1.475	1.239
	Immediate liquidity	2.531	2.132	1.073	0.781	0.650
	Sight liquidity	2.017	1.529	0.292	0.286	0.079
	ACID test	2.017	1.529	0.292	0.076	0.079
	Economic lever	-	2.20	4.82	-0.92	0.37
	Financial lever	-	2.85	3.66	-1.17	-1.45
	Score function	2.785	2.958	2.022	1.719	1.509
Cost	The average interest rate	2.90%	0.00%	0.00%	0.13%	15.63%
	Average tax rate	15.86%	10.24%	17.29%	36.32%	19.40%
	Tax savings	0.46%	0.00%	0.00%	0.05%	3.03%
	The cost of borrowed capital	2.44%	0.00%	0.00%	0.08%	12.60%
	The cost of equity	1.32%	1.78%	1.92%	0.00%	0.00%
	The weighted average cost	1.51%	1.50%	1.60%	0.02%	3.94%
	Economic value added	32.24%	33.88%	30.17%	33.47%	20.15%
Valuation bases	The impact of revaluation reserves	0.00%	0.61%	0.44%	0.38%	0.58%

Source: own elaboration

In the bottom part of the balance sheet, the situation of the current assets structure shows a little different than happens in most frequent cases, i.e. appears the anomaly of increasing evolution of receivables and, in particular, of stocks [6].

Such a development automatically induces an acute deterioration of the entity's treasury that provides early information about the possibility of financial imbalances installation [14].

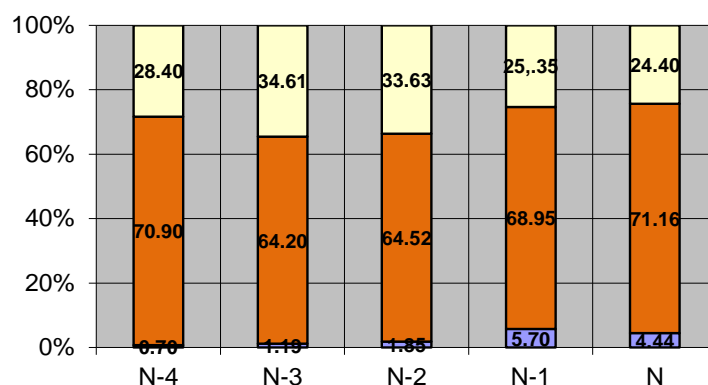


Figure 1. The fixed assets structure of a listed company for a five years time period

Table 2.

The treasury of a listed company during a five years time period

	N-4	N-3	N-2	N-1	N
Profit before tax	1.683.423.208 lei	2.546.166.973 lei	2.149.627.028 lei	1.605.563.340 lei	1.697.519.745 lei
Net treasury generated from operating activity	2.771.300.260 lei	2.954.789.370 lei	2.485.377.106 lei	4.383.615.591 lei	2.656.968.662 lei
	-	183.489.110 lei	-469.412.264 lei	1.898.238.485 lei	-1.726.646.929 lei
	-	6,62%	-15,89%	76,38%	-39,39%
Net treasury used in investing activity	-2.170.111.346 lei	-3.167.623.570 lei	-3.760.781.518 lei	-5.528.758.491 lei	-4.058.494.992 lei
	-	-997.512.224 lei	-593.157.948 lei	-1.767.976.973 lei	1.470.263.499 lei
	-	45,97%	18,73%	47,01%	-26,59%
Net treasury used in financing activity	-218.847.795 lei	-836.100.465 lei	-1.422.986.498 lei	653.946.441 lei	1.420.123.809 lei
	-	-617.252.670 lei	-586.886.033 lei	2.076.932.939 lei	766.177.368 lei
	-	182,05%	-29,81%	-245,96%	17,16%
Total cash flow	382.341.119 lei	-1.048.934.665 lei	-2.698.390.910 lei	-491.196.459 lei	18.597.479 lei
	-	-1.431.275.784 lei	-1.649.456.245 lei	2.207.194.451 lei	509.793.938 lei
	-	-374,35%	157,25%	-81,80%	-103,79%
Cash and cash equivalents at the beginning of the year	4.117.609.227 lei	4.499.950.346 lei	3.451.015.681 lei	752.624.771 lei	261.428.312 lei
Cash and cash equivalents at the end of the year	4.499.950.346 lei	3.451.015.681 lei	752.624.771 lei	261.428.312 lei	280.025.791 lei

Source: own elaboration

It is true that an excessive treasury becomes „lazy” as long as there it is not effectively harnessed by allocating the cash placements, or, why not, by financing an

investment or portfolio of profitable investments at a rate at least equal to the rate of the risk-free interest on the capital market. In our case, it appears that the entity wants to pursue a new direction in terms of cashing the value of production sold [7].

This can occur for various reasons; however, such a policy certainly was preceded by an analysis of the creditworthiness of customers, which gives some safety for the collection in the future of the debts paid. This statement is supported by the degree of hedging, through the registration of the depreciation adjustments, which are up to the share of 50% of the total receivable balance customers [3].

Furthermore, a slowly accumulation of inventories does nothing but to block indefinitely a significant part of the company's cash. There is no question in this case, regarding the real impact of the registration of unsalable stocks.

The treasury is presented progressive in Table 2) [9].

Scenarios on the cause of this situation appearance are numerous, but the macroeconomic conjuncture conditions have a big say, in particular by paying the current debt policy of the state.

The elasticity of oil assets is null. But if the demand suffers decreases repeatedly, the entity cannot afford to record sub-activity costs, given the increased share of fixed costs within the amount of total costs [5].

When it comes to the financing policy of the entity, we refer, in other words, to the structure of financing of specific activities. It is noticeable that, in the first phase, the financial structure of the entity coincides in relative terms, with the share of the equity.

So, the entity opts for a funding policy on account of hiring treasury loans, especially „cash-polling” loans. In these circumstances, the entity enjoys greater autonomy and an enviable degree of solvency, which gives the entity the possibility of getting new financing under extreme advantageous conditions.

Only within the recent years, it appears that the entity is also looking forward for a long term loan. However, the entity presents a greater degree of financial security, considering the positive development of the capacity to repay loan installments on account of affecting the self-financing capacity.

It is quite clear that the policy of financing the entity falls within a balanced policy boundaries aimed at ensuring continuity and financial stability:

Table 3.

The financing indicators of a listed company for a five years time period

Indicator	N-4	N-3	N-2	N-1	N
Global autonomy	82.56%	84.39%	83.49%	73.27%	68.77%
Overall indebtedness	17.44%	15.61%	16.51%	26.73%	31.23%
Financial stability	82.83%	84.54%	83.66%	81.39%	82.58%
Financial indebtedness	99.68%	99.82%	99.80%	90.02%	83.28%
Repayment capacity	96.01%	73.41%	90.64%	84.75%	128.40%
Financial balance rate	52.13%	53.81%	73.71%	86.24%	75.27%

Source: own elaboration

However, the variation recorded in the amount of the liquidity, due to the dilution of the period of sales collection, correlated with an yearly consistent spore of commercial debts increase generates significant changes within the amount of the financing flows, and less in the size of the cash flows:

Table 4.**The rotation indicators of a listed company for a five years time period**

Indicator	N-4	N-3	N-2	N-1	N
Receivables rotation	38.90 days	37.98 days	59.89 days	37.13 days	57.86 days
Stock rotation	50.34 days	40.89 days	57.12 days	52.17 days	59.63 days
Commercial credits rotation	25.66 days	33.16 days	52.32 days	48.61 days	55.51 days
Period of cash deficit	63.59 days	45.70 days	64.69 days	40.70 days	61.98 days

Source: own elaboration

Periods of high storage of up to 2 months, reflect a situation typical for large enterprises, given the size of marketed production and distribution frequencies for major clients of the company. However, this situation is considered quite risky, as long as the supply process can even reach to be blocked just because of the incapacity of paying to an important customer, such as the state [15].

This aspect was remarked also within the entity's liquidity indicators which describe a steep downward trend, inducing a potential risk of payment incapacity for the future:

Table 5.**The liquidity indicators of a listed company for a five years time period**

Indicator	N-4	N-3	N-2	N-1	N
Current liquidity	3.196	2.781	1.818	1.475	1.239
Immediate liquidity	2.531	2.132	1.073	0.781	0.650
Sight liquidity	2.017	1.529	0.292	0.286	0.079
ACID test	2.017	1.529	0.292	0.076	0.079

Source: own elaboration

All these are due to the configuration of the profitability - risk binomial. This binomial, in a simplified sense, requires that any marginal risk assumed by the entity must be paid as such, so that the marginal investment involving a profitability spore is sufficiently motivating for decision makers [2].

Such an approach calls also the total cost structure which has to be classified in fixed costs, respectively variable costs.

From this stellar graph emerge a series of correlations between different rates aiming the solvency of the company. It is noticed quite easily that, although the entity has a capacity for debt due repayment, liquidity size decreases from one year to another, exposing the enterprise to a greater risk of default. However, this evolution is not a concern as long as it is confirmed an encouraging trend of the cash flow. The leverage indicators express, in different conceptions, the impact of the variation of the tax value in the size of the exercise's result [4].

Thus, if economic leverage effect measures the changes in gross profit from operations, the change with a unit of fiscal value, $\frac{\partial Profit_{gross}}{\partial CA} \times \frac{CA_0}{P_0}$, while the financial leverage effect considers also the size of the financial expenses, reporting the variation of the net profit to a unitary change of the tax value $\frac{\partial Profit_{net}}{\partial CA} \times \frac{CA_0}{Profit_{net_0}}$ to a change unit turnover. As shown in the figures, indeed, the share of fixed costs is considerable within the cost structure of the entity, as a variation of the tax value has really a devastating impact on the size of profits, be it the operating profit or the net profit [1].

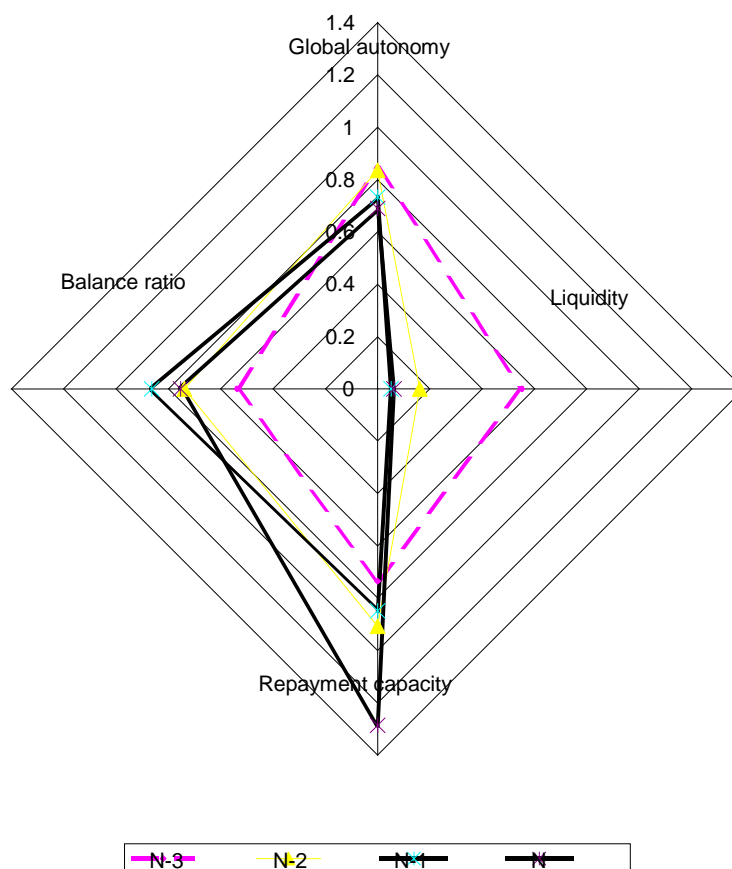


Figure 2. The solvency indicators of a listed company for a five years time period

The score function is the value of the score function Băileșteanu, built for the Romania case in 1998. This uses as an evaluation tool the linear function of the form $f = 0.444 \cdot G_1 + 0.909 \cdot G_2 + 0.0526 \cdot G_3 + 0.0333 \cdot G_4 + 1.414$, where G_1 - current liquidity ratio, G_2 - solvency ratio, G_3 - customer turnover rate and G_4 - the profitability rate of return costs [1].

The recitals from which started the selection of this model are that the score function Băileșteanu reflected in greater extent the autochthonous economic environment, given that the empirical study is based on figures regarding the Romanian companies. Moreover, this model perceives the risk of bankruptcy in terms of solvency, liquidity and profitability of the company, indicators that summarize in one form or another both management policies of the operating cycle and the scope of the funding policy [8].

If the value of the function is lower than 0.5, then it is considered a bankrupt state under imminent. Range (0.5; 1.1) is considered limited range; range (1.1; 2.0) is considered the intermediate zone, while if the function has a higher value than 2, then it is considered that the entity is in a favorable zone [2].

No just and maybe, we can consider that the entity Petrom has a healthy economic and financial situation, without being exposed to the risk of bankruptcy in the near future:

Also, the balance sheet structure and mandatory annexes to the financial statements, notes also the visible impact of the choice of the assessment base, representing the fair value, as specified in the measurement principles of the financial statements package. The entity operates yearly value adjustments on the net book value of assets subjected to revaluation treatment under the law. Therefore we find also an important value of the balance of revaluation reserve in the amount of equity. Although the percentage size

of 0.40% does not say much, in absolute size, revaluation reserves present a significant fluctuating evolution, but in relative terms, constantly [10].

Table 6.**The risk indicators of a listed company for a five years time period**

Indicator	N-4	N-3	N-2	N-1	N
Economic leverage	-	2.20	4.82	-0.92	0.37
Financial leverage	-	2.85	3.66	-1.17	-1.45
Score function	4.199	4.372	3.436	3.133	2.923

Source: own elaboration

Depreciation size fits also within a framework of evolving fairly steady, hovering around 6% of the net assets. This significant share of depreciation brings in the income statement of the entity tax savings of about 0.96 percent, meaning in absolute values, a not at all negligible amount [12].

Although the entity presents a low economic and financial risk, it records relevant profitability rates. Inelastic demand of products traded by our entity gives us a competitive advantage, specifically to the entire sector:

Table 7.**The profitability indicators of a listed company for a five years time period**

Indicator	N-4	N-3	N-2	N-1	N
Commercial profitability	91.25%	96.44%	18.96%	8.39%	16.70%
Economic profitability	10.58%	14.34%	9.28%	5.25%	4.48%
Financial profitability	13.20%	18.54%	13.49%	7.53%	9.73%

Source: own elaboration

The leverage effect generates in the purse of the entity, due to the deductibility of interests, a significant amount of tax savings, whose percentage size is given by the difference between the economic profitability and, respectively, the financial profitability, weighted with the parity rate of shareholders' contributions and creditors' contributions.

The economic profitability is defined as the ratio between gross operating profit, respectively, the size of the capital invested, while the financial profitability is the net gain obtained by the entity by affecting a unit of the own funds [11].

CONCLUSIONS

The corporate governance principles ensure the conservation and the development portfolio of the shareholders, meeting the efforts of the specialists in order to reduce the adverse effects of the information asymmetry phenomenon.

Although the implementation of such a set of principles, through an organizational structure well built, aims huge costs, the marginal gain of shareholders and of the other external users materializes in a confidence-building in leadership and also an additional motivation in getting significant real performance.

We will not lie on the classification of these indicators, as this section is intended only to provide a mirror of the overall economic situation of our entity, and just to give clues on likely future developments [6].

Embarking upon a fascinating insight of the financial management through the rate system, we keep in mind some basic principles in the corporate finance, namely, the financial policies of the entity must follow a well-defined direction, coupled with the entity's strategy in the medium and long term.

This direction must, however, take into account several fundamental rules in finance, namely:

- ✓ the minimum financial balance rule, whereby stable funding allocations should be covered only from sustainable sources, and also the financing of the need for structural working capital should be financed at the expense of working capital;
- ✓ the maximum borrowing rule, which implies that banking practice indicates to the companies that the size of borrowed funds should be fully covered by affecting equity;
- ✓ the repayment capacity rule, which implies that the yearly size of financial liabilities does not have to exceed 3-4 times the average yearly self-financing capacity provided;
- ✓ the minimum self-financing rule, translated by requiring the entity's contribution to the financing of investment projects for which the credit is requested [2].

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