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RATIO ANALYSIS AS A BASIC TOOL OF ENTERPRISE FINANCIAL CONDITION EVALUATION

Abstract: The paper presents the main aims of financial analysis, which is one of the most important tool evaluating the financial condition of the enterprise. Empirical researches have been run and presented in the paper. To the researches the Polish company of furniture industry has been chosen.

Keywords: financial analysis, liquidity ratio, turnover ratio, profitability ratio

Introduction

The activity of each enterprise depend on its internal factors on which the enterprise can influence and external factors on which the influence its no possible every time. The market, competition and surrounding in which the enterprise acts, force some kinds of behaviors and acts of this enterprise. The aim of those active is to maintenance the competition advantage, increase the sales and effectiveness functioning. Functioning in the market economy force on the enterprise to continuous observation of changes in the surrounding and to analyze the financial, material and human resources. Information related to these area are the base to decision process on all management level.[1] To reach these goals the managing personnel should take the right decisions. One of the tools of decision making is financial analysis.[2]

Financial analysis on the one hand make possible to diagnose the enterprise condition on the other hand allow to make certain decision concerned its future activities. The main aim of financial analysis is to prepare and transform the information about the activity, outcomes and economical - financial situation of enterprise which are the main source to decision process.[3] The main source of information used in financial analysis are financial statements to which belongs: balance sheet, income statement, cash flow statement. Moreover also data from different index cards as economical plans, calculation, are used.

Ratio analysis allows to evaluate the financial condition of the enterprise. Its task is to count many of relation between balance sheet data and income statement data. This is the way to describe and characterize different enterprise activity area. Ratio analysis can be divide into following ratio groups:[4]

- liquidity ratio,
- turnover ratio,
- profitability ratio,
- activity ratio,
- debt ratio,
- capital market ratio.

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[1] A. Musialik, M. Musialik, L. Kurzak: Analiza finansowa jako miara efektywności zarządzania przedsiębiorstwem. Zeszyty Naukowe Uniwersytetu Szczecińskiego nr 406, Uniwersytet Szczeciński 2005.
[2] Z. Leszczyński, A, Skowronek - Mielczarek: Analiza ekonomiczno - finansowa firmy. Difin, Warszawa 2001, s. 9.
[3] M. Sierpińska, T. Jachna: Ocena przedsiębiorstw według standardów światowych. PWN, Warszawa 1999, s.39.
[4] A. Rutkowski: Zarządzanie finansami. PWE, Warszawa 2003,s.81.

Financial analysis of furniture company

The company is one of the largest Polish producers and exporters of fumiture. The company was established in the year 1992 and since then it has become a leader on the Polish furniture market.[1] To the basic products of company belongs home furniture and kitchen furniture. Production of home furniture, among other things, include:

- system,
- wall units,
- office furniture.

Production of kitchen furniture includes 16 programs which distinguish the furniture with respect to the technology in production process, used raw –materials and design. The company exports fumiture to 30 countries of the world. Nowadays the company share in Polish fumiture market is about 10%. The company acts on wide European market and from 2002 started to Ukraine market. Nowadays the company invest on Russia market.

Table 1. The structures ratio, %

	2001	2002	2003	2004	2005
Fixed Assets/Total Assets	47,06	45,41	45,83	51,65	59,15
Current Assets/Total Assets	52,94	54,59	54,17	48,35	40,85
Equity/Total Liabilities	56,20	56,29	56,96	69,62	64,70
Equity/Fixed Assets	119,42	1123,96	124,29	134,78	109,39
Constant Capital/Fixed Assets	126,68	143,42	158,51	150,99	137,01
Current Assets/ Current Liabilities	76,28	63,88	50,50	45,53	46,41

Source: author's calculation

Financial ratios are the way to comparing and investigating the relationship between different pieces of financial information.[2]

The share of fixed assets in balance sheet has increased systematically since 2003. It's caused by huge growth of long-term investments, which are part of fixed assets. In the year 2004 the long-term investments raised about 207 % in comparison to the year previous year, and in the year 2005 – about 73%. Slight changes in the others elements of fixed assets were observed. Taking under consideration the branch in which acts given company, the lower level of current asset and the same time higher level of fixed asset is regarded as correct. The company keeps so called "golden rule of balancing". According to this rule fixed elements of assets should be financed by equity, cause that part of assets is bounded with the company for the long-term. Till the year 2004 equity/fixed assets ratio has grow, but in the year 2005 the fall down about 25 percent points have been noticed. However the value of equity is high enough and fixed assets are covered by it. Such situation testifies strong financial fundamentals in the company. Adding to equity the value of long-term liabilities, the constant capital is created. Constant capital called also long-term capital is required in the company. It serves to finance all company's needs characteristics of fixed assets and partly the current assets. The constant capital/fixed assets ratio amounts above 130% in the whole period. That means the company posses enough value of long-term capital which finance not only the relatively long life assets but also the current asset, which has the life of less then 12 months. The value of short-term liabilities has systematically decreased from the level 74 thousand zloty in the year 2001 to 52 thousand zloty in 2005. The value of long-term liabilities in whole researched period has reached in different way. The lowest value long-term liabilities achieved in 2002 – 4 thousand zloty, while in 2005 it was 51 thousand zloty.

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[1] Company's data

[2] S.A. Ross, R.W., Westerfield, B.D., Jordan: Fundamentals of Corporate Finance. Irwin, Boston, 1993.

Table 2. Liquidity ratios

	2001	2002	2003	2004	2005
Current ratio	1,33	1,76	2,23	2,43	2,49
Quick ratio	0,78	1,10	1,38	1,61	1,42
Cash ratio	0,19	0,24	0,20	0,53	0,03
Net working capital	24 734	46 981	63 512	83 890	78 170

Source: author's calculation

Liquidity measures concern is the firm's ability to pay its bills over and short run.[1] The current ratio is defined as current assets to current liabilities and its right level is from 1,2 to 2,0. The quick ratio is another measure of company's liquidity. This ratio is computed just like current ratio, only inventories are excepted from current assets. From all elements of current assets inventories are at least liquid. The proper level of quick ratio amounts about 1. A very short-term liquidity measure is cash ratio, which is defined as cash to current liabilities. This ratio shows how much liabilities can the company cover at once. It is taken on that the level of this ratio is about 0,2. Current ratio and quick ratio in the researched period have increased systematically. Current ratio grow from the level 1,33 in the year 2003 to the level 2,49 in 2005.As far as at the beginning the ratio hold lower limit of norm, but then in 2003 it exceeded the upper limit. That situation shows the company posses surplus of current assets. Also the analysis of quick ratio confirm over –liquidity. At the beginning the quick ratio amounted about 1 which was interpreted as a right level. Nowadays it's level suggests large level of current assets mostly caused by possessed receivables. The level of cash in the company has been proper till the year 2003. However, the cash ratio in the last two years presents dissimilar situation. In the year 2004 the cash ratio increased and it was caused not by growth of cash and by fall of current liabilities. In 2005 the cash ratio decreased dramatically (cash ratio = 0,03), but value of cash in the company was on the lowest level. The financial liquidity in the company is on safety level. It is also confirmed by the value of net working capital. Net working capital is the difference between company's current assets and its current liabilities. Positive value of net working capital reduces the risk from finance the current assets as well as protects from unfair contractors.

Table 3. Turnover ratios, in days

	2001	2002	2003	2004	2005
Days' sales in Inventory	69,9	56,0	54,5	59,49	66,70
Days' sales in Receivables	73,4	66,8	74,6	80,72	86,74
Days' sales in Payables	68,1	54,6	26,7	34,52	57,13
Cash Cycle	143,3	122,8	129,2	105,68	96,31

Source: author's calculation

Turnover ratios do not present advantageously. Inventory turnovers ratio shows that the shortest time of turning the inventories amounted 54 days in 2003. Nowadays it takes 67 days. It means that company turn inventories about 7 times per year and now about 5,5 times per year. Taking under consideration the furniture industry sector, this ratio could not be regarded as disadvantageous however it is necessary to avoid to lengthen this ratio. The level of receivables turnover ratio is wrongly. The shortest ratio amounts 67 days in 2003 while the longest - 87 days in the year 2005. The proper value of receivable turnover ratio should amount 36 – 60 days. The counted ratios show that company excessively gives credit to the delivers and customers. The company is not able to collect the receivable. Taking about the liabilities turnover ratio, the company pays the liabilities in terms. In the years 2003 – 2004 the term of liabilities payments was very short about 25 – 35 days. Nowadays this

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[1] [1] S.A. Ross, R.W., Westerfield, B.D., Jordan: Fundamentals of Corporate Finance. Irwin, Boston, 1993.

term has rise to the upper limit and amounts 57 days. The company should pay more attention to the efficiency using its current assets.

Table 4. Profitability ratios, %

	2001	2002	2003	2004	2005
Operating Profit Margin	-3,68	6,17	9,05	4,62	1,90
Gross Profit Margin	-3,66	2,92	4,63	7,71	3,13
Net Profit Margin	-3,42	2,80	3,11	6,18	2,43
Return on Assets	-4,90	3,73	4,11	5,89	2,16
Return on Equity	-8,71	6,63	7,22	8,46	3,34

Source: author's calculation

The group of profitability ratios is the best known and widely used financial ratios. The profit margin is the most significant ratio because it focuses on measuring that element of profit over which company has the greatest control.[1] The profit margin ratios can be computed using different kinds of incomes: operating profit, gross profit or net profit in relation to sales. During the researched period the company recorded the loss in 2001 but next years have yield profits. The 2004 year was next year of high growth of sales. Among the furniture companies which are quotation on stock exchange the described company reach the best outcome of sales. Thanks to using all favourable market conditions, effective system of furniture distribution, especially on foreign markets such situation was possible. The export sales amounts 53% of total sales. Gained profit in the year 2005 is much lower then previous year and it is a consequence of strengthening of Polish zloty in relation to Euro. The strengthening of Polish zloty had significant influence on export sales value. The export sales amounts 58,7% of total revenues from sales in the year 2005.

Return on assets (ROA) shows how effectively the company uses its assets and it is defined as net profit to total assets. Return on Equity (ROE) is a measure of effective equity using. Cause the company uses debt in financing its activity, the ROE is much higher then ROA. However, like the profit margin ratios, the value of ROE and ROA decreased last year.

Table 5. Long Term Solvency and Financial Leverage Ratios

	2001	2002	2003	2004	2005
Total debt ratio	0,44	0,44	0,43	0,30	0,35
Debt/Equity ratio	0,78	0,78	0,76	0,44	0,55
Long term debt ratio	0,02	0,08	0,15	0,08	0,16
Times Interest Earned Ratio	-3,25	8,70	17,75	6,86	3,20

Source: author's calculation

Total debt ratio describes how much of financial sources come from debt. It shows the structure of company finance. According to counted ratios the company takes the opportunity of using debt in financing its activity. Debt financing in researches company is on the average level. In the years 2001 – 2003 amounted about 44 % of total liabilities, while a next years has decreased and its amounts 35% in the year 2005. Mostly the debt consists of short -term liabilities. Long term debt ratio show that the share of this kind of debt in total liabilities amounted 15% in 2003 and 16% in 2005. In left years the share was lower then 10%. Another common measure of long-term solvency is the time interest earned ratio. Aforementioned ratio is defined as earns before interest and taxes (EBIT) in relation to interest. This ratio measures how the company is able to pay the interest. On counted ratio influences

[1] P. O'Regan: Financial Information Analysis. John Wiley & Sons, Ltd., England, 2001, s.251.

the value of EBIT. Because the highest value of operating profit the company gained in the year 2003, this ratio also high value. Nowadays, the value of operating profit fall down and the same situation has been observed into ratio level.

Summary

Run researches shows that the company has a strong position on Polish market and also makes many investments which aim to expand on others foreign markets, especially on eastern market. The financial results present good condition of company. Attention should be paid only for turnover ratios which levels wander from limits. The gained profits by company show how important role is featured to the value of Euro. It is cause that more then 50% of total sales comes from export.

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STIMULATING THE AVAILABILITY OF A CREDIT BY APPLICATION OF THE REGISTERED PLEDGE

Summary: Asset-backed financing is an important segment of the credit sector. A registered pledge plays an important role in stimulating the availability of credit. This improves the terms on which credit is granted. But a pledge only serves this role effectively if it provides an efficient means of reducing risk. A registered pledge may become a factor for determining whether or not credit is available. This is particularly the case for small and medium-sized enterprises where the unsecured risk is often high. The elaboration presents regulations referring to a registered pledge in the Polish legal system concerning creating a registered pledge, the risk of loss of the security, ways of enforcing security and shows the reasons why a registered pledge in Poland is incapable of performing its functions.

Key words: securing the claims, credit, registered pledge

Introduction

Back in the early 1990s, Poland faced an urgent need to introduce viable rules for securing transactions. New investments to regenerate the economies were dependent on a credit. Few potential borrowers had the credit record, the balance sheet or the banking relationships that would persuade lenders to advance money on viable terms. What was needed was a simple means of using assets to support credit thereby giving the lenders the confidence to lend and regain money and borrowers the access to a credit on more advantageous terms.

The reform of the registered pledge law has been motivated by this simple objective. A credit remains the lifeblood of a marked-basset economy and security has an ever-growing role in nourishing the market for credit.[1]

A registered pledge plays an important role in stimulating the availability of credit. But a pledge only serves this role effectively if it provides an efficient means of reducing risk. A registered pledge may

[1] European Bank for Reconstruction and Development report „The impact of the legal framework on secured credit market in Poland" www.nbp.com.pl