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The financial position and performance of the economic entities from the Light Industry

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Abstract: *The Romanian light industry plays a significant role within the national economy, especially if we refer to the number of jobs created in this field. In this regard, the assessment of the financial standing and performance of the business entities from this field is of particular importance not only for the national economy but also in terms of the interests pursued by the management of the company, its shareholders, trading partners and creditors. In this respect, this paper focuses first on the investigation and analysis of the financial reports of 45 business entities which are representative for the Romanian light industry (divided into three main constitutive parts: companies producing textiles, clothing and footwear) and secondly, on highlighting the main similarities and differences from the point of view of the main financial indicators.*

Key-words: *financial standing, financial performance, light industry, risks*

1. Introduction

Light industry comprises business entities that may be divided into 3 main production activities: textile production, clothing production and leather and footwear production. In Romania, the light industry is an important field of the national economy on one hand, from the point of view of the tradition it has in the export activity (it is of utmost importance to state that in 2003 and 2004, Romania was the leader among clothing exporters on the EU market, even if it stared to decline in the following years) being as well the main employer in the industry, and on the other hand, with regard to the qualitative high education offered in the field (the specific academic specializations offered by Romanian universities).

In this respect, the industries of textiles and clothing, leather and footwear are among the very few industries (together with furniture and unprocessed wood industries) for which Romania has a sectorial specialization index higher than one, this specialization index calculating a country's specialization in the *j* industry as compared to another country or region (the EU, in this case) (Visileanu 2008, 139). Thus, worldwide well-known companies have preferred to invest in Romania in the

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development of production units and factories/plants because of the low labour costs as well as of the qualified personnel. Light industry is an industry with tradition, with companies operating for over 100 years and it is represented in almost all the counties of the country, even if there is a certain concentration in certain regions such as the North-Western, North-Eastern and Central Development Regions and Bucharest as well.

Statistics show that some important factor as for instance the liberalization of the European market towards Asian exports, the increase of the prices of raw materials, the increase in utility tariffs, high taxes and other factors of economic circumstances have recently generated a slight decline in the textile industry: there have been noticed decreases in production and exports, in the number of business entities and in the number of employees as well as reductions in the wages etc. Under these circumstances, it is necessary to periodically assess the financial health of the companies from this field, to identify the tendencies in liquidity, solvency and labour productivity and the evolution of their financial performance, the aim of this paper being also to encourage entrepreneurship in the field by underlining the success of such type of business. Thus, the users of accounting information may benefit from a set of financial data useful in their decision making processes.

2. Research methodology

The main purpose of the study, as it was previously mentioned, is to determine the financial health of the business entities from the textile, clothing and footwear industry. The paper focuses on the analysis of the financial standing and performance of the business entities from this industry. The sample on which the study was undertaken consists of 45 business entities from the light industry, as follows: 15 business entities specialized in the production of fabrics, fibre preparation and spinning; 15 business entities producing clothing and 15 business entities producing footwear. The selection was made based on the turnover and the number of employees, namely on medium and large enterprises. The companies included in the sample are representative for the field they belong to as a result of their tradition and experience of over 10 years in the light industry. Data were taken and processed from the business entities' financial statements which are published on the website of the Romanian Ministry of Finance. The analysis implied the investigation of the financial statements of certain consecutive financial years, so as, for the analysed period of six years (2008-2013), the examination of financial statements enhances the value of this paper. The selection of the set of financial indicators was conditioned by the availability of financial data provided by the Romanian Administration of Public Finance (ANAF).

The financial standing of a business entity is evidenced by the accounting information published in the financial statements, namely according to the financial standing reflected in the balance sheet and to the financial performance reflected in the profit and loss account. Every economic decision made in a company requires not only a strict and precise analysis of all the economic and financial transactions, but also of the data provided by the financial statements.

Hence, this paper presents an analysis of the evolution and dynamics of the financial standing and financial performance reflected in the financial statements of entities from the textile, clothing and footwear industry. The analysis is based on a set of 7 variables: asset liquidity, overall solvency, degree of indebtedness, labour productivity, turnover, net profit and financial return. The selected financial indicators can be used in order to make predictions about the financial health of a business entity and the capacity to attract an investment, in order to analyse tendencies and to compare the performance / profitability between fields or companies.

Achieving the objectives of the research takes into consideration the following hypotheses:

H0: There are no significant differences in liquidity, solvency and financial return of companies in the three fields: textiles, clothing and footwear

H1: There are significant differences between the liquidity, solvency and financial return of companies in the three fields: textiles, clothing and footwear.

Moreover, the pieces of information needed for the analysis of the financial standing of a company are provided mainly by the balance sheet. The analysis of the financial standing involves an analysis of the evolution and structure of assets, liabilities and equity.

The rates of the structure of the financial standing (assets, liabilities and equity) highlight the entity's financial characteristics such as the ability to turn assets into cash, autonomy and financial independence of the entity, the quality of the financial balance on short and long term etc. With regard to the financial standing, the financial equilibrium of an economic entity may be measured with the help of the indicators of liquidity and solvency. A first embodiment of the entity's financial balance is achieved by ensuring the continuous ability of the company to pay, both on short and long term. In a general sense, liquidity and financial solvency represent the entity's ability to meet its due payments (Borlea 2010, 7).

An important indicator regarding the financial standing of an economic entity is the asset liquidity (AL) which reflects the ratio between the current assets of a company and its total assets. The indicator provides information about the liquidity of the assets of an economic entity with regard to the timeframe in which it can pay off its debts to its creditors.

The analysed companies did not show significant fluctuations as concerns the liquidity of assets, so we can highlight its relative constancy from year to year. Current assets represent more than 50% of total assets, this being a positive sign of the possibility of the business entities to honour their debts and thus to maintain a sufficient distance from the risk of insolvency. However, entities have a poor structure of current assets, in terms of the high proportion of stocks and claims and less of available funds. It is necessary in this regard, to accelerate the stocks rotation rate (Anton 2009, 160) and also to rethink the lending policies regarding client relationships. Increased debt may mean granting comfortable payment terms for customers, but also the appearance of uncertain claims. It appears that there are no significant differences between the three sectors (textiles, clothing and footwear) in terms of liquidity of assets. Values slightly higher (but not significantly different) can be noticed in the footwear field.

Indicators that can draw a signal about the insolvency of the business entities and the possibility of the risk of bankruptcy are in general, solvency and the degree of indebtedness. Overall solvency (OS) is another financial indicator analysed in the present paper, designed to provide an overview of the business entity's ability to meet its payments to creditors, both on short and long term. This indicator could signal their risk of insolvency, it expressing the extent to which the assets of the company help finance the amount of total debt, being calculated as the ratio of total assets and total liabilities.

The greatest than 1 the value of the overall solvency ratio is, the better the overall financial situation of the entities is. The analysis reveals that most entities have recorded values above the minimum accepted level. The lowest level is of 1.42 (among companies producing fabrics) and the highest being 3.44 (among footwear companies). The companies included in the sample have a good overall solvency (>1.3). Companies producing fabrics record a lower level of the overall solvency ratio and a higher risk of insolvency as compared to the other business entities. The highest values of debt that have had an increasing tendency (over LEI 31 million in all 6 analysed years) were registered by companies producing fabrics. Companies producing clothing and footwear recorded a lower level of debt (between LEI 2 million and 11 million), thus the risk of insolvency and default is lower, the companies having the possibility to convert assets into cash in order to honour their obligations.

An indicator that can quantify the amount of external financing in relation to the possibility of self-standing of an economic entity is the degree of indebtedness (DI). The degree of indebtedness is calculated as the ratio between total debt and equity. The higher the value of this indicator is the more the business entity depends on loans or commercial debts. A reasonable situation requires that this indicator does not exceed the threshold of 0.5.

The business entities that have experienced high levels of the indebtedness degree to its creditors are the ones producing fabrics, preparing and spinning fibres. Given the high level of indebtedness, registered by the analysed business entities, we can say that their funding depends less on their own resources and more on borrowed sources (usually bank loans). The analysed entities may face the danger of insolvency, reflecting an increased dependence on foreign sources.

An indicator that measures the economic efficiency of the enterprises and reflects the effectiveness and fruitfulness of labour in the production process is the labour productivity (LP). Increased labour productivity represents an important factor to increase the volume of production, reduce production costs and increase the profitability and competitiveness of the products. Annual labour productivity is determined as a ratio between the turnover and the average number of employees. Labour productivity, in the case of the analysed business entities showed a slight increase from one year to another, but it was driven mainly by redundancies that have occurred rather than the increase of the turnover. In 2013, the average number of employees in the fabrics field ranged between 86 and 723; in the clothing sector between 53 and 1,339 and last but not least, between 50 and 1,349 in the footwear sector.

In this respect, in all the sectors of the light industry there may be noticed a tendency to reduce the average number of employees (ANE). The financial year of 2010 are marked by sharper declines (84.24% decreases in the average number of employees for companies producing clothing and 91.58% for the footwear manufacturing companies), followed by a slight recovery thereafter.

In order to evaluate the performance of the business entities from the light industry, the following indicators were analysed: turnover, net profit and financial return. The financial performance of an economic entity is its ability to obtain profit from its business. Thus, for an economic entity to be efficient in terms of financial conditions, it is necessary for the activity to be profitable, to primarily permit the remuneration of all production factors involved, but also achieving a surplus, represented by the overall result of the economic activity. An indicator that measures the performance of companies, also used as a criterion for their classification according to their economic importance is the turnover (T). The turnover represents the value of the sales amount made within a period of time by a business entity. This indicator allows the assessment of the position of the company in its business sector, of its market position, of its skills to launch or develop different activities in a profitable way. At the same time, a change in the value of the turnover is reflected on the main economic and financial indicators as well as on the companies' efficiency. In the manufacturing sector, the net turnover (T) expresses all the revenues received from the sale of the products obtained, highlighting the total business volume.

The companies from the fabrics sector recorded lower values of the turnover compared to those obtained by the companies from the other two sectors, but that shows a slight increase. In the period of 2011-2012, companies from the footwear sector held supremacy. The upward tendency registered by turnover is due to the increase of the production sold (positive tendency of production based on orders). The year 2013 is marked by decreases of the turnover by 89.66% in the clothing sector and by 75.77% in the footwear sector (considering the median values). There can be noticed a fairly large discrepancy between companies within the same sector, in terms of the level of turnover.

Another indicator that shows the financial performance of each sector is the net result. This indicator expresses the efficiency of the entire activity developed by the economic entities. The higher values (median) were recorded by the footwear sector (between LEI 684,000 and 1,900 thousand), followed by the clothing sector (from LEI 400 thousand to 500 thousand) and the fabric sector (from LEI 140 thousand to 900 thousand). The year 2013 is marked by a decrease of the net income due to an increase in the total costs.

Another indicator that expresses the ability of a business entity to obtain profit is the rate of return on equity (ROE). Return on equity is a significant indicator for assessing the economic and financial performance of an enterprise not just for the internal diagnosis, but also for the analyses required by the external partners (Căruntu and Lăpăduşi 2009, 95). The financial return on equity expresses company's ability to generate profit and its efficiency when using its equity. Depending on the rate of this indicator, shareholders appreciate if their investment is justified and if they are to continue with investing. It is calculated as a ratio between the net profit and the value of the equity. Thus a high rate of the financial return allows the company to generate consistent returns for the shareholders. The higher the financial rate of return is the more net worth the company has at its disposal (Vasilache 2009, 38).

Return on equity has been fluctuating between 1.02 and 23.71. The rate was negatively affected by the losses in the fabrics sector (in 2012). Financial year 2010 finds the companies from the footwear sector in a negative curve due to the losses recorded, but with a return in the future years when positive values were registered. The losses were caused by incidental factors, such as increases in the prices of raw materials and utilities. Negative values were recorded by 2 out of the 15 economic entities in the footwear sector (these losses have much exceeded the profits made by the other economic entities). In order to increase the rate of the financial return and to stabilize the economic situation of the business entities, it is required that the net profit grow at a higher rate compared to the growth of the equity.

3. Results and discussions

The analysis of the financial reports was made following two main directions: the analysis of the financial standing and the analysis of the performance of the business entities from the light industry. There were also analysed the financial data for 45 companies in the light industry for the period 2008-2013. The indicators that were calculated and compared were: assets liquidity, overall solvency, degree of indebtedness, labour productivity, turnover, net profit and financial return.

Thus, the financial standing regarding the liquidity, solvency and financial return is almost the same, there are no significant differences among the three sectors of activity (textiles, clothing and footwear), making us to accept the null hypothesis. The differences between the values obtained for these indicators are based on the time period analysed. The period of 2011-2012 and the first half of 2013 was marked by a turnover increase, the most important contribution to the increase in turnover being held by the footwear and clothing fields. According to the liquidity and solvency indicators, light industry companies had a strong financial standing and enough liquid assets to maintain the business operations. The results indicate that the footwear sector is in a better position in terms of liquidity and solvency as compared to other labour fields. Labour productivity has recorded a slight increase from one year to another, but unfortunately this was driven mainly by the redundancies that have occurred rather than by an increase of the turnover. Return on equity has been fluctuating, with a tendency to decrease in last years. The diagnostic analysis performed has shown the fact that light industry entities have also crossed difficult times, especially between 2010 and 2012. The economic crisis from the recent past has led to a contraction of internal and external demand and a distortion of the financial indicators. In 2010 there were registered layoffs and cuts by 80% of the average number of employees (in clothing and textiles field) whereas in 2012 there have been accumulated the most debts and there were recorded the lowest rates of overall solvency and of financial return.

Last, but not least, another finding of this study relates to the sensitive position of the fabrics field concerning the degree of indebtedness. According to our opinion, their borrowing rate should concern the stakeholders as it is much higher than in other fields, indicating a relatively low self-standing potential, their financing sources being mainly external. It is true that business owners want to grow their business and for such a reason they need loans, but excessively high values may announce a possible bankruptcy. One possibility to reduce the debt would be to compensate claims with debts, thus eliminating the possible penalties for delay. Also, the increase in ROE of the fabrics companies (this is the field that registered lower values) and of the clothing companies as well, is important to attract growth capital investments.

4. Conclusions

To conclude, we notice that the business entities from the light industry present, overall, a favourable financial standing and positive financial performances which may generate them a significant added value, as seen from the indicators calculated here in above. With the results of this study, the stakeholders (users of the accounting information) may be able to shape the profile and observe the financial structure of the economic entities from the light industry, also appreciating the policy of collecting the claims, of managing current assets, the financial profitability, the ability to pay debts and by default, the risk of insolvency.

In this regard, the values and tendencies registered by the calculated indicators (especially the overall solvency and the degree of indebtedness) reveal that the business entities from the light industry find themselves at a certain distance from the risk of insolvency and inability in paying debts. However, it is required that the managers of these companies be aware of the necessity of a precise diagnosis of the economic entity in time, within the contemporary business environment, to be able to notify as early as possible the financial difficulties (the level of the risk) and to plan a long term strategy. Thus, financial and accounting information can help managers and other users of accounting information to reduce uncertainty in the decision making process.

Furthermore, our further research may be centred on a more detailed analysis of the factors that affect liquidity, solvency and profitability, but it should focus on an increase in the sample size to analyse small and medium-sized entities too. An empirical quantitative analysis (based on questionnaire) regarding the frequency which companies from the light industries undertake analysis of their financial reports with, may also be performed trying also to identify the main strategic alternatives used by the companies in the light industry to meet the challenges of the heterogeneous business environment.

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