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## Article

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# The Analysis of Financial Equilibrium Through the Influence of Economic Performance: Case Study for the Romanian Clothing Industry

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## Abstract

The economic performance of the companies in the Romanian clothing industry can be analyzed through the profitability highlighted by its influence on the financial equilibrium. Considered an essential component of financial position and performance, profitability implies the ability of the company to obtain long-term future benefits in the form of the realized profit. The current research captures the factors influencing the economic performance on the financial equilibrium in the Romanian clothing industry in order to follow and improve the financial results for keeping the companies on the market within the competitive economy. The results of the research show that at the level of the company analyzed there is a negative correlation between certain rates described, therefore the company presents a poor financial situation. As the analysis of the financial equilibrium on the case study does not record values that would fit the company in the area of financial equilibrium, we consider that a detailed evaluation of the financial evolution of the company necessary.

## Keywords

Economic performance, financial equilibrium, rates of return, Net Treasury, Romanian clothing industry

**JEL Codes:** G32, L67

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## 1. Introduction

Financial status, as the main attribute of economic performance is the determining factor used for decision making by managers, shareholders and employees of the company, as well as by the other categories of partners with whom the company interacts: customers, suppliers, other business partners, investors, banks, other financial institutions, as well as trade union and state organizations. The analysis of the financial status of the company is based on the financial data provided by the annual financial statements, which is the main source that provides accounting information about the company. Therefore we support the opinion of State (2006), which is of the opinion that the financial status and performance of a company can be analysis through:

- the analysis of the financial balance in order to harmonize the resources and their efficient use;
- analysis of the financial rates by which the possibility of comparisons between companies in time and space is offered;
- risk analysis, in order to avoid the situation in which the company reaches the state of financial instability;
- analysis of the financial results obtained by applying statistical models, which will allow the forecasting of future events, by using certain data already known.

Performance in economic theory and practice, is approached from an accounting point of view through financial performance. It occupies a significant place in the economic life, but until it is deepened, we consider it appropriate to highlight the need to know in advance the large-scale performance of the entities analyzed from an economic point of view, called "economic performance". Economic theory presents multiple levels of understanding of economic performance in entities. One of these refers to "the profit or profitability of the entity, which means accounting and financial measurement of performance or efficiency, leading to the idea of optimal result. The second level refers to the indicators of social effectiveness where the notion of "conflict" represents the starting point in its assessment, being the assessment of the social climate of the entity, and the third direction of understanding the performance refers to the domain" (Dănilă, 2014).

At present, the concept of economic performance knows a variety of definitions, in the sense that "to reach a consensus regarding the definition of performance it is quite difficult, because the field in which this term is used must be taken into account" (Cardoş and Muţ, 2012).

We consider that the definition given by Sava (1999) is a complex one - the economic performance represents "the level at which a sector of activity reaches the goals or objectives pursued by the companies that operate within it. The performance is multi-dimensional, covering aspects related to profitability, innovation, product design, quality and growth".

## 2. Literature review

The financial equilibrium can be defined by "the ability of the company to ensure the payment of the debts contracted previously without interruption, including the debt incurred in the implementation of the current object of activity or the fiscal law, so that it can avoid the risk of bankruptcy". (Căruntu, 2011). Gudž (2017) considers that the financial equilibrium is an internal factor of development of the financial and economic potential of the company that increases its adaptability to changes in the modern market environment. We agree with Nicolaescu (2013), who states that the financial equilibrium "generally implies the idea of harmony between different elements of a system or, in financial terms, represents the equality between the financial and economic sources necessary for the development of an activity. The financial equilibrium, although it has many meanings, can be defined as the ability of the company to ensure payments through cash receipts, in order to avoid the risk of bankruptcy".

the context of globalization, the financial equilibrium presents the following valences (Achim *et al.*, 2008):

- the financial equilibrium is achieved in order to ensure the capacity of the short-term payment debts and also for the long-term in order to quantify it using the indicators for liquidity and solvency;
- the financial equilibrium at the level of the exploitation is emphasized with the help of the indicator - working capital, which appears and which is calculated from the balance sheet structure;
- the achievement of the financial equilibrium at the level of the management of the short-term controlled resources by the company, and the equilibrium of the management of the long-term controlled resources by the company seems to be realized as a residual value. The equilibrium of this level is accentuated by the use of rotation rates (asset rotation, customer debt rotation, contract debt rotation). In this way we can identify this type of equilibrium as a equilibrium realized by the indicators for the administration activity;
- a special role is given to the treasury - the financial equilibrium at the monetary level (between earnings and expenses) being very necessary to ensure a general equilibrium for the whole activity.

The financial equilibrium, as Dănuțiu and Dănuțiu (2008) show, is a component of the economic balance, whose estimation - at the company level - depends on the objectives of the people who order or study such analyzes.

Professor Burja (2009) presents the state of financial equilibrium as appearing when the conditions referring to: achieving long-term objectives, not using the degree of indebtedness in order to increase the profitability, develop the company through the use of equity, functioning in order to reach the correlation between needs-resources, so otherwise the company is experiencing financial disequilibrium. After analyzing the speciation literature we can say that the financial equilibrium most often in the economic practice is analyzed through the Accounting balance sheet, which determines the Net working capital, Need for working capital and Net cash to show the influence of the financial position on the financial equilibrium. In the following, we will try to show what is the influence of the financial performance on the financial equilibrium by studying the profitability rates using the Profit and Loss Account. As a synthesis document of the analysis of income and expenses, the Profit and Loss Account (Teiușan, 2006) evaluates the performance of the company according to the profit measurement.

## 3. Methodology of research

The vast specialized literature offers numerous possibilities to study the profitability based on the Profit and Loss Account - as an annual financial situation (Zuca and Alice, 2012; Bistriceanu *et al.*, 1995; Eros-Stark and Pinte, 2001; Stancu, 2002). However, we consider that the most probable rates of return for studying the financial equilibrium, refer to the Rate of return on total current assets, Rate of return on short-term debt, Rate of return on current assets and Rate of return on current debts and credits.

Table 1. The factors of influence of the financial equilibrium specific to the Profit and Loss Account

Indicators	Formula	Explanation
Rate of return on total current assets ( $R_{ACT}$ )	$R_{ACT} = \frac{RAO}{AC} \times 100$	It shows the contribution of the use of the total current assets in the formation of the operating result
Short-term Debt Return Rate ( $R_{DTS}$ )	$R_{DTS} = \frac{RAO}{DTS} \times 100$	It quantifies the efficiency of using the financial sources from the company's short-term debt

Indicators	Formula	Explanation
Rate of return on current assets ( $R_{ACrt}$ )	$R_{ACrt} = \frac{RAO}{AC-CCB} \times 100$	It reflects the efficiency of the exploitation and financial activity of the company capable of generating positive financial results by using the current economic means
Debt and current loan rate ( $R_{DCCrt}$ )	$R_{DCCrt} = \frac{RAO}{DTS-CT} \times 100$	It expresses the efficiency resulting from the training of the sources attracted in its own financing

**Source:** Own processing by Burja (2009), p. 337.

Where:  $RAO$  - The result from the operational activity

$AC$  - Current assets

$DTS$  - Short-term debt

$CCB$  - House and bank accounts

$CT$  - Cash loans

Based on them in Burja (2009, pp. 337-340), three correlations were analyzed through the following levels of financial equilibrium:

- *long-term equilibrium* - obtained by comparing the rate of return on current assets with that of short-term debt return:

$$R_{ACT} < R_{DTS} \quad (1)$$

When the same financial result of the operation is obtained by a larger size of the current assets compared to the short-term payment obligations, it results that the rate of return of the current assets is lower than that of the short-term debt return.

- *current financial equilibrium* - obtained by comparing the rate of return of current assets with that of return on current liabilities and loans:

$$R_{ACT} > R_{DCCrt} \quad (2)$$

The formation of the financial equilibrium can be ensured in the temporary activities of the company only when temporary financing sources are attracted from outside the company, at the same level as the fixed assets in stocks, receivables but also an increase of money availability.

- *the general equilibrium of the operation* - from correlation (1) and (2) thus:

1.  $R_{ACT} < R_{DTS}$  and  $R_{ACT} > R_{DCCrt}$  - occurs when the conditions of profitability are met at the same time;

2.  $R_{ACT} < R_{DTS}$  and  $R_{ACT} < R_{DCCrt}$  - appears in 2 forms:

- *stable financial equilibrium*: occurs when a diversion of the basic destination of working capital occurs;
- *classic financial equilibrium*: occurs when the surplus of temporary needs becomes the cause of a short-term financial disequilibrium, due to the lack of working capital financing.

3.  $R_{ACT} > R_{DTS}$  and  $R_{ACT} > R_{DCCrt}$  - occurs when there is a financial disequilibrium in the level of permanent activity, it appears due to the need to finance fixed assets;

4.  $R_{ACT} > R_{DTS}$  and  $R_{ACT} < R_{DCCrt}$  - occurs when there is a financial disequilibrium both at the level of the permanent activity and at the level of the temporary activity.

The analysis of the balance or, as the case may be, of the financial disequilibrium achieved through the rates of return implies a complement of the analysis of the financial equilibrium indicators specific to the financial position.

#### 4. Results and Discussions

CONF Ltd. (fictitious company for confidentiality reasons) is a representative company in the Romanian garment industry, for which we consider as appropriate the outline of a detailed analysis of the financial statement. Through the series production achieved, due to the prestige and the performances achieved through the Manufacture of men's clothing, for the important clients from Europe the company has proven professionalism managing to obtain a Turnover equal to 35.97 million lei, thus ranking itself. in the Top 50 according to the turnover - CAEN 1413, for the year 2017, according to the data published on the Top Companies website in Romania.

For an efficient analysis, in the table 2 we present, according to years, the financial indicators necessary in analyzing and establishing the financial equilibrium situation at the company level.

Table 2. Dynamics of financial indicators at CONF Ltd.

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<i>Indicators</i> <i>Years</i>	AC	CCB	DTS	CT	RAO
2011	15,776,808	47,035	8,661,424	0	5,254,717
2012	16,635,892	185,038	9,207,237	0	2,680,349
2013	17,560,050	476,610	5,236,106	0	3,115,884
2014	12,068,738	-3,187,282	6,036,964	308,057	100,289
2015	11,391,041	-5,884,820	7,024,288	0	1,655,583
2016	14,290,506	-5,542,366	8,964,762	0	1,630,003
2017	11,770,512	-6,836,222	5,786,473	946,063	635,118

**Source:** Own processing based on the financial statements of CONF Ltd.

According to the analysis of the table 2, we find that CONF Ltd. presents a significant share of current assets, which means that the company presents goods that generally participate in a single economic circuit. We identify a not very good situation of the money availability, which between 2014-2017 presents negative values, so it is surprised an unfavorable situation in terms of the financial equilibrium. We observe a decrease of the House and bank accounts between 2013 and 2014 as a result of large payments made. SC. CONF SRL. we find that he manages to cover his debts from his own sources until 2014, when he applies for bank loans. The same situation is observed in 2017, when the company uses a bank loan 2 times higher than the first and this is the most coverage of some investments made. The last indicator analyzed is the result of the operational or operating activity found in the Profit and Loss Account. We find that it shows constant variations from one year to the next, and this is due to the expenses which are higher especially in the years where bank loans were used.

Using the annual financial statements of CONF Ltd. for a period of 7 years, we perform an analysis of the financial equilibrium through the rates of profitability, thus we outline the table 3:

Table 3. The influence of economic performance on the financial equilibrium

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<i>Indicators</i> <i>Years</i>	$R_{ACT}$	$R_{DTS}$	$R_{ACrt}$	$R_{DCCrt}$	$R_{ACT} - R_{DTS}$	$R_{ACrt} - R_{DCCrt}$
2011	33.31	11171.93	0.33	60.67	-11138.62	-60.33
2012	16.11	1448.54	0.16	29.11	-1432.43	-28.95
2013	17.74	653.76	0.18	59.51	-636.02	-59.33
2014	0.83	-3.15	0.01	1.75	3.98	-1.74
2015	14.53	-28.13	0.10	23.57	42.67	-23.47
2016	11.41	-29.41	0.08	18.18	40.82	-18.10
2017	5.40	-9.29	0.03	13.12	14.69	-13.09

**Source:** Own processing based on the financial statements of SC. CONF SRL.

The study of the financial equilibrium by the rate of return of the current assets presents us weights oscillating from one year to the next. Therefore, we find that it decreased in 2012 compared to 2011 by 17.20%; and in 2014 compared to 2013 it increased by 16.91% as a result of the oscillations that we found to present the result of the operation. A similar situation is also observed for the rate of return on short-term debt which, as a result of the money availability indicator, presents negative values. We find that this rate decreased from the reference period to the base period by 11181.22%. After analyzing the rate of return of current assets we can say that the efficiency of the operating activity is reflected in a low proportion because this rate fails to rise in any year over 0.33%. As a result of the percentages obtained from the rate of return on debt and loans, we can say that in most of the analyzed years they express the efficiency resulting from the incurring of non-financial debt in own financing.

The correlation  $R_{ACT} < R_{DTS}$  presents in the first 3 years of the analysis of the value of the return of the current assets lower than that of the return of the short term debts, and in the following years 2014-2017 the recorded situation is exactly the reverse - the values of the return of the current assets greater than those profitability of short-term debt. Therefore, we can

say that between 2011-2013 the analyzed company is solvable, because the current assets exceed the short-term liabilities, and between 2014-2017, the company is not solvable because the current assets fail to cover the short-term debts. The second correlation  $R_{ACRt} < R_{DCCRt}$  shows a lower return on current assets compared to the return on current liabilities and loans. Therefore, a financial imbalance can be noticed at the level of CONF Ltd. strongly emphasized in the first 3 years. In order to diagnose the company and to identify its financial status at the level of the entire analysis period, we present in table 4, financial equilibrium indicators - net working capital, need for working capital and net cash.

Table 4. Dynamics of financial equilibrium indicators specific to the balance sheet

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<i>Indicators</i> <i>Years</i>	<i>FRN</i>	<i>NFR</i>	<i>TN</i>
2011	7,115,384	7,068,349	47,035
2012	7,447,965	7,262,927	185,038
2013	12,330,408	11,853,798	476,610
2014	6,031,774	9,219,056	-3,187,282
2015	4,366,753	10,251,573	-5,884,820
2016	5,325,744	10,868,110	-5,542,366
2017	5,984,039	12,820,261	-6,836,222

**Source:** Own processing based on the financial statements of SC. CONF SRL.

Where: *FRN* - Net working capital; *NFR* - The need for working capital; *TN* - Net cash.

Net working capital analyzed at CONF Ltd. during the years 2011-2017 presents positive values which meant that there is a long-term financial equilibrium. Also, the company's resources are large enough that they can cover the investment and operating needs. On the other hand, those bank loans identified in 2 years of the analysis, can generate the financial risk due to the degree of indebtedness. The need for working capital shows that stocks and receivables are higher than temporary resources, so that finally a positive net treasury was identified between 2011-2013, and in the following years the net treasury is negative, which means that CONF Ltd. it will have to measure the permanent sources, so as to cover the investment needs, but also those of the operating activity.

## 5. Conclusions

We consider this analysis of the financial equilibrium based on the Profit and Loss Account useful because there are numerous situations in which the economic activities of a company, although they are profitable, from the perspective of the financial balance, show disagreements between the financing sources practiced and needs.

The determination of the influence of the economic performance on the financial equilibrium was made on the basis of the profitability analysis - the rate of return of current assets, the rate of return on short-term debt, the rate of return on current assets and the rate of return on current debts and credits. Based on these we surprised the commercial company CONF Ltd., which is a representative company in the clothing industry, the correlation of  $R_{ACT} < R_{DTS}$  and  $R_{ACRt} < R_{DCCRt}$  which shows a stable solvency situation between 2011-2013, followed by a slightly unstable one if we report the correlation  $R_{ACT} < R_{DTS}$  between 2014-2017.

We consider that CONF Ltd. financial self-equilibrium can be achieved by increasing economic profitability. Obtaining greater results of the economic asset will mean implicitly the increase of the net working capital, so the permanent sources will be able to cover the operating and investment needs, without the need to use bank loans, in this way the net treasury increases and becomes positive.

Finally, we can say that the analyzed company in the Romanian clothing industry is in the suboptimal equilibrium situation, both by analyzing it based on the Balance sheet where the net Treasury was determined, and based on the Profit and Loss Account where the correlation was established between rates of return.

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