BETTER TIMES TO COME?

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In several issues of this journal[1] the author has focused on the financial situation in Slovak businesses – its level, development and an analysis of the causes resulting in – as has been stated several times – a highly adverse state. The statistical material presented in these articles leads to the conclusion that for the average Slovak business in the period analysed (1993 – 1999) characteristic features are primary insolvency, shortage of own funds, a high level of debt, complicated further also by the high cost of outside funds and a low level of the process of raising corporate value, presented mostly by negative profitability.

The article in no. 12/2000 of the BIATEC journal finishes with the following paragraph: "The partial results of Slovak businesses for the year 2000 give cause for a certain hope. Reports on the profitability of businesses, on the growing interest of foreign investors in capital investment are published with increasing frequency. Also acceptance into the elite OECD club of countries could cause a sequence of weak and strong years to differ from that in the dream about cows and hay stables dreamt by the Egyptian pharaoh. There is hope here that after seven weak years (1993 – 1999) a series of seven (or more) rich years is to come."

The aim of this article is to analyse whether these signs of a recovery registered in the year 2000 are territorial and of a permanent nature, whether the process of increasing the value of Slovak businesses has set off a positive trend and whether the above mentioned external influences have positively affected the Slovak economy and its business sector.

The financial situation of businesses is shown by means of standard proportionate financial indicators characterising their ability to cover liabilities, utilisation of assets, level of debt and overall profitability. Their selection will essentially correspond to indicators used in the previous articles and therefore we will not comment on their construction, which is generally known. The set of businesses represented in the data ranges from several tens of thousands in the case of the whole set through to several tens or hundreds of businesses in the case of selected sectors, it may however be said that the sets on the basis of their size provide statistically significant representative information.

The development of the financial situation and its level are not shown only by means of average results, but we will take into account the use of quartiles and their variability, which gives a more plastic image of the development of the financial situation of businesses. In order to interpret the results correctly it is however necessary to take into account the nature of the indicator. This means the desired development of the indicator. For those indicators for which a growth in their value is desired (e.g. liquidity, profitability, etc) the upper quartile (UQ) is the limit for the quarter of the best businesses, conversely for indicators whose value should decline over time (e.g. turnover time) the UQ is the limit for the quarter of the worst businesses. Interpretation of the lower quartile (LQ) is converse. In the space between the UQ and LQ we thus find half the set of businesses, this being the band of average results.

In assessing the financial situation we will consider the results of businesses for the period 1998 – 2001[2]. The starting point will be the whole set containing production, commercial and service businesses. We subsequently break this down according to the line of business, making it possible to identify the different (or identical) trends in the development of the financial situation, according to the Classification of Economic Activity by Industry – the main groups. We undertake a deeper analysis in the case of production businesses by looking into selected sectors of production.

Development of the financial situation in the whole set of businesses

The basic indicators evaluating the development of the financial situation in the whole set of businesses for the years 1998 – 2001 are shown in Table 1. Conclusions are stated in the case of the individual types of indicators.

Liquidity of businesses

The liquidity of businesses as represented by the three indicators L1, L2 and L3 records an unusual, even contrary development.

First degree liquidity (L1) meaning the most liquid part of assets – financial assets and short-term liabilities together – should total, according to generally accepted principles, a value of 0.2 or more. Concurrently however

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[1] e.g. Zalai, K.: Development of the Financial Situation of Slovak Businesses over 1993 – 1997, BIATEC no. 12/1998, Development of the Financial Situation of Slovak Businesses over 1993 – 1999, BIATEC no. 12/2000, Analysis of the Profitability of Slovak Business over 1996 – 2000, BIATEC no. 12/2001.

[2] The length of the selected period is determined in particular by the size of tables and the possibility of their inclusion into the text. The source of the data is the Slovak Bank Clearing Centre.

Table 1 Results of the whole set of businesses

	Years		1998	1999	2000	2001
	Size of set		39 515	44 277	48 556	42 448
Liquidity indicators	First degree liquidity L_1 (coeff.)	UQ	0.46	0.47	0.51	0.57
		Me	0.12	0.12	0.12	0.13
		LQ	0.02	0.02	0.02	0.02
	Current liquidity L_2 (coefff.)	UQ	1.23	1.24	1.28	1.36
		Me	0.71	0.68	0.69	0.71
		LQ	0.26	0.24	0.23	0.22
	Overall liquidity L_3 (coeff.)	UQ	1.49	1.50	1.55	1.64
		Me	0.95	0.93	0.93	0.95
		LQ	0.44	0.40	0.38	0.35
Activity indicators	Stock turnover time (days) STT	UQ	31.81	32.38	29.01	25.01
		Me	0.55	0.38	0.04	0.00
		LQ	0.00	0.00	0.00	0.00
	Short-term trade receivable payment term (days) STTRPT	UQ	79.59	79.59	72.44	68.45
		Me	23.13	22.91	20.09	18.80
		LQ	0.00	0.00	0.00	0.00
	Short-term trade liabilities payment term (days) STTLPT	UQ	123.26	122.50	108.53	96.08
		Me	36.81	34.50	26.41	22.30
		LQ	0.00	0.00	0.00	0.00
Debt indicators	Total debt against assets TD/A (%)	UQ	102.64	105.18	106.83	104.16
		Me	81.38	81.95	81.40	78.18
		LQ	33.54	32.00	29.69	26.00
	Interest coverage (%) IC (coeff.)	UQ	1.11	1.01	1.00	1.44
		Me	0.00	0.00	0.00	0.00
		LQ	0.00	0.00	0.00	0.00
	Debt flow (year) DF	UQ	9999	9999	9999	9999
		Me	27.28	30.90	27.04	17.23
		LQ	3.65	3.75	2.85	2.10
Profitability indicators	Price/earning ratio (%) P/E	UQ	0.67	0.62	0.90	1.79
		Me	0.00	0.00	0.00	0.00
		LQ	-5.33	-5.96	-5.12	-2.48
	Return on equity (%) ROE	UQ	3.51	2.60	3.75	9.00
		Me	-2.36	-2.46	-2.08	-0.37
		LQ	-43.90	-41.30	-38.35	-25.49
	Return on assets (%) ROA	UQ	1.33	1.19	1.72	3.20
		Me	-0.38	-0.43	-0.38	0.00
		LQ	-9.41	-10.07	-9.45	-6.78

a value of 0.6 and above is considered unnecessarily high. The average result over the whole period is very stable, being 0.12, only in 2001 rising to 0.13, which is quite far from the desired value. It is true that a quarter of businesses (those above the upper quartile) have significantly better results and, what is especially important, that these results show a significantly marked improvement from 0.46 to 0.57. Conversely, the quarter of businesses at the opposite end of the set (those below the lower quartile) have the very low value of 0.02 consistently throughout the whole period.

Current liquidity (L2) should move in the range 1 – 1.5. Lower values may be tolerated only by a business with a low share of receivables (retail). The average result is balanced; were it not for the result 0.71 in 1998, it may be said that a slight improvement is occurring. Nevertheless, the quarter of the best businesses is located in the desired interval of values and, moreover, shows a balanced and continual improvement in the UQ from 1.23 to 1.36, which is an improvement of more than 10%. The quarter of the worst businesses is developing in the opposite direction. These businesses report very far from good results and the value of the band limit has fallen from 0.26 to 0.22.

Overall liquidity (L3) tracks this same state and development. The average result is not good and is stable. Businesses above the upper quartile limit record a continual and marked improvement from 1.49 to 1.64, which is also an improvement of 10%. A converse development of results is exhibited by businesses below the lower quartile limit, where the limit value has fallen from 0.47 to 0.35, bearing witness to the low and worsening ability of these businesses to cover their liabilities.

Activity of businesses

The activity of businesses expressing the level of asset utilisation is represented by turnover indicators. The interpretation of the indicators used is complicated by the fact that the lower quartile limit in all cases equals zero, which is difficult to explain in some cases.

Stock turnover time has recorded a positive development. The average turnover time and has shortened, however also the turnover time in the case of the quarter of the worst businesses has shortened (this time, the UQ limit) and the quarter of the best businesses (now, the LQ limit) works as if without holding any stocks. There are several explanations for this development. Certainly there is a rational pressure on managing stocks, in which significant funds are tied up. There is, however, also involved the effect of insufficient finance, which necessitates their irrational reduction. Lastly, there has been the intense effect of change in the structure of the set of businesses. In 1998 the share of production businesses, which are most demanding in terms of stocks, was 28.83% of the total set of businesses and in 2001 was only 26.23%. Conversely, the share of service businesses, which are least demanding in terms of stocks, and which in many cases work entirely without holding stocks, grew from 29.46% in 1998 to 31.99% in 2001.

Payment term of short-term trade receivables has also shown a positive development. The average result improved from 23.13 days to 18.8 days, which is an improvement of more than 18%. It is significant that the payment term improved also in the case of the quarter of the worst businesses, where the UQ limit moved from 79.59 days to 68.45 days, an improvement of 14%. The quarter of the best businesses do not have any payment problems, receiving payment immediately. Payment term of short-term trade liabilities. The development of these indicators is identical to that in the previous case. The average term of payment shortened and the UQ value also fell.

Businesses debt levels

The level of debt of a business characterises the structure of its financial resources and, by means of this, the business's stability. For a description of this aspect we have used three indicators.

Total debt against assets (TD/A) is an indicator quantifying the share of outside funds for covering the assets of a business. On average this share is very high, though nevertheless falling. In 1998 the average share of outside funds was 81.38%, in 2001 this figure had fallen to 78.18%. This is a lot; the European view on debt levels considers the upper limit to be 70% (this is however not a dogma). The UQ shows that more than a quarter of businesses work with negative equity, only on the basis of "outsider money". Conversely a quarter of businesses have a very low share up of outside funds and over the course of the period this figure fell further. These businesses are very stable, on the other hand however they do not utilise the positive effect of financial leverage.

Interest Coverage (IC) expresses the ability to cover the cost of outside funds. Only businesses falling within the lower quartile of the TD/A indicator are able to do so (the indicators TD/A and IC are of a converse nature).

Debt flow (DF) is an indicator quantifying a business's ability to return outside funds on the basis of the balance sheet CF (cash revenue + depreciation). On average this ability is very low in 1998 27 years were necessary, in 2001, 17 years. Compared to the demands of standard market conditions (3 – 5 years) this is several times above the limit. A substantial share of the businesses are not able to do this at all, because they have a negative balance sheet cash flow (shown in the interpretation as 9999). Conversely, businesses in the lower quartile are able to do so at the desired level and in 2001 were able to return outside funds in approximately 2 years.

Overall profitability

Overall profitability, integrating and synthesising the results reported in the previous three fields is reflected in profitability indicators. All three indicators – price / earnings ratio, return on equity and return on assets are through their level unsatisfactory. The majority of businesses operate at a loss and the median of the indicators ROE and ROA have negative values (the p/e ratio is in the case of a different business). It is indisputable however that there is an improving trend in all these negative indicators at all layers of the set of businesses.

Return on revenue

The price/earnings ratio shows that in 1998 the upper quartile was SKK 0.0067 of profit per SKK 1 of earnings, but in 2001 was SKK 0.0179, which is a 267% improvement. Conversely, the lower quartile in 1998 reported a SKK 0.0533 loss per SKK 1 of earnings, but in 2001 "only" a loss of SKK 0.0248.

A similar development – a growth in profitability quantified by the upper quartile and fall in loss-making quantified by the median and lower quartile – is also recorded by the indicators ROE and ROA.

Conclusion

The ability of businesses to cover their liabilities and function normally in the market environment is good, or passable, improving only in a small share of the set, comprising one quarter. In the individual years there are around 9 900 to 12 100 businesses. Other businesses have unsatisfactory results and a large share even worsening results.

Activity indicators report an improvement, indicating a growing utilisation of assets in businesses. In evaluating the situation and in particular the future development it is necessary to take account of many facts, such as the massive start-up of chain stores, the growing number and share of foreign business partners with pressure on extending terms for payment.

The level of debt of most Slovak businesses is inappropriately high and signs of any improvement in the situation are negligible. There is, however, a group of businesses (approximately a quarter) with a low level of debt, where their financial situation allows the share of outside funds to increase (own funds to decrease).

The partial improvement of the results and the gradual stabilisation is reflected in the positive development in their profitability, which however is still far from the standard results of businesses of developed market economies. These results also demonstrate that the effect of financial leverage, resulting from the favourable relationship between profitability of total capital, cost of outside funds (interest rate) and the level of debt, is used only by the best businesses and that this source of raising own capital profitability is at present still only a rarity.

Next issue: Development of the Financial Situation by the Main Groups of the Classification of Economic Activity by Industry