



## BETTER TIMES TO COME?

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*Continued from issue 8/2003*

### Development of the financial situation by the Classification of Economic Activity by Industry – main groups

In this article we focus on whether there exist any significant differences in the trends in changes to the financial situation of businesses falling into the main groups of the Classification of Economic Activity by Industry (CEAI), i.e. production, trade (wholesale as well as retail) and service businesses. The relevant data are shown in Table 2.

**Liquidity** of businesses in different sectors shows significant differences, in which sectoral specifics are reflected.

**Available liquidity ( $L_1$ )** reaches its highest average level (Me) in service businesses; its level is close to the recommended value, 0.2, and indeed in 2001 reached this point. Businesses in the other sectors are quite far from this limit and balanced as a whole. At the level of the upper quartile there are however already noticeable differences between them. The limit of the quarter of the best businesses (UQ) is lowest in the case of production businesses and gradually increases through wholesale, retail businesses through to service businesses, where it is highest. This applies, with the exception of retail businesses, also for the lower quartile. Also the development of the  $L_1$  indicator is most dynamic in the case of the service sector.

**Current liquidity ( $L_2$ )** taking account of short-term receivables is on average also highest in services, but production businesses are now in second place, followed by wholesale and this group finishes with retail, in which most transactions are made in cash. The situation is identical in the case of the UQ and LQ. Even here it is shown that the average result is stable, despite the different level in individual sectors. Only the best businesses report an improvement in their payment ability, most significantly in services, where the UQ improved from a value of 1.53 in 1998 to 1.81 in 2001, i.e. by 18.3%.

**Total liquidity ( $L_3$ )** takes into account also the tied-up nature of stocks, and is on average the most balanced. It is surprising that service businesses continued to be the leader, although stocks in their case should be relatively the lowest. The highest stocks (relatively) are tied up in

production businesses falling into the lower quartile, which has the highest value. The most dynamic positive change is recorded by the upper quartile of service businesses, which in the period analysed grew by more than 15%.

**Utilisation of business's assets** is the most significantly influenced by a business's sector. This is connected with their different investment, material and energy demands. An effect is also had by standard (in some cases also non-standard) manners of payment, possibilities to provide trade credit, etc. Here it is therefore inappropriate to derive conclusions from the absolute values of the indicators; more important are the rate of changes and their direction.

The direction of the indicators' development is, in each sector, positive; turnover time is shortening, both in the case of the average value (Me), as well as at the upper quartile level, which in the case of the turnover indicators, is the level of the businesses with the worst results. The most dynamic changes are recorded in production businesses and service businesses, where the turnover time shortened to 20 – 40%, which is a significant result. Of course, in the background there may be also a non-standard (and even undesirable) effects. For example, the favourable development of the average term of payment for trade receivables may be influenced by forced payments in cash, deposits paid in advance, etc, which are facts indicating the occurrence of market failures. Overall however the development may be seen as positive.

**Structure of financial resources** expresses the financial independence, or level of a business's debt.

This, like the indicator TD/A, is on average (Me) very high and in every sector of activity exceeds 70%. The differentiation of the average level of debt by sector of activity is not so great; the highest is in wholesale, the lowest in services. The UQ value is higher than 100, meaning that more than a quarter of businesses operate with negative equity. More dynamic changes are recorded by only the quarter of the best businesses, in which there is occurring, as in each sector, a reduction in the level of debt. It is questionable, however, whether this may be unequivocally seen in a positive light, since a substantial part of this set is formed by economically successful businesses, which could cash in on the effect of financial leverage from a growth in their level of debt.





The interest coverage indicator expresses the ability of businesses to pay the cost of outside funds. This ability is generally very low, a positive result is seen only in the upper quartile and in none of the sectors does it exceed the limit 3 accepted abroad.

A similar situation can be seen also in debt flow. The ability to return outside funds is in general low. The average result comes to tens of years, lasting longest in wholesale and retail businesses, shortest in services. The UQ value illustrates the inability of a large share of businesses to settle their debt at all and only the lower quartile exhibits acceptable results in this band. A positive feature is only the fact that the median as well as the long-term quartile are recording a positive development – the period necessary for return is shortening.

**Business profitability** is very low, but exhibits a positive development.

The median of the price / earnings indicator is in a different business than in the case of the ROE and ROA indicators, therefore it has a non-negative value. Overall the picture of the development of Slovak businesses' profitability is nevertheless comparable by all indicators.

The average results of ROA and ROE are improved which means specifically that negative profitability (loss-making) is on the decrease, in 2001 this in every sector reached zero. Loss-making also is falling as measured at the lower quartile and a positive development is shown also in the development of the upper quartile value. The price / earnings ratio, the return on equity and assets in all sectors of activity in this part of the set of businesses is improving significantly. The most dynamic changes are in trade businesses (wholesale and retail), where the value of profitability indicators in 2001 grew on 1998 by three to four times. A positive, but less dynamic, development is shown in production businesses and in service businesses. Here the profitability indicator values double.

### Conclusion

On the basis of the indicators calculated for the whole set of businesses we reach a moderately optimistic conclusion on the existence of visible symptoms of an improvement in the financial situation of Slovak businesses. The results structured by the main sectors of activity lead to a recognition that this recovery is general and it is apparent in every sector. Sectoral specifics objectively and significantly influence certain indicators (for example, liquidity and activity), but the direction of their development is the same, positive, the results according to sectors also confirm that a share of businesses (approximately a quarter) in each sector have adapted to the new conditions, their results are continually improving, their financial situation is stable and

results are approaching those of businesses from countries having developed market economies. It is highly probable that this share (quarter) in the case of each of the indicators used contains the same businesses.

### Development of the financial situation in selected production sectors

The effort to make more objective and verify the above conclusions leads us to probe into production sectors. The orientation on production sectors and businesses is connected with their indispensable role in the economy's development, where we have chosen those that are traditional, or in which large Slovak businesses operate. The scope of the article allows us to concentrate only on selected production sectors.

The selected production sectors are stated in the sequence corresponding to their position in decree no. 552/2002 of the Digest of Laws, through which is issued the statistical sectoral classification of economic activities. The reader will certainly assess in an analogous manner for him/herself the data presented; the author's commentary shall be restricted only to a basic statement.

**Textile production** (Table 3) is a traditional sector for Slovak industry. Businesses belonging to this sector are marked by low liquidity with a moderate improvement in the share of the best businesses and with a stagnation or worsening of results of businesses at the opposite end of the set. Evident signs of an improvement are shown in the utilisation of assets; turnover indicators have a positive development. The level of debt is very high, higher than the average in the whole set of businesses (Table 1 in the previous issue); the ability to return outside resources is again improving substantially. All three profitability indicators are recording favourable results, continual growth, in all bands of the set of businesses – average, above average and below average.

**Production of chemicals and chemical products** (Table 3). In this production sector important businesses operate having a great impact on the Slovak Republic's balance of trade. The results for liquidity indicate a high rate of variability in the set and marked differences in the results and financial situations of businesses. Activity indicators report differing results (e.g. stock turnover time). The level of debt is significantly lower than the Slovak average. Profitability indicators are developing favourably, with profitability growing and loss-making on the decrease.

**Production of rubber and plastic products.** Businesses in this sector have low liquidity with an absence of any signs improvement in the situation. This applies for all bands in the set. We do not register any significant progress either in the case of activity indicators.



Table 3

Years		Textile production				Production of chemicals and chemical products				
		1998	1999	2000	2001	1998	1999	2000	2001	
Size of set		198	230	228	187	126	149	167	149	
Liquidity indicators	First degree liquidity L <sub>1</sub> (coeff.)	UQ	0.25	0.25	0.30	0.27	0.32	0.20	0.31	0.43
		Me	0.07	0.08	0.10	0.06	0.08	0.08	0.07	0.08
		LQ	0.02	0.01	0.02	0.02	0.02	0.01	0.01	0.01
	Current liquidity L <sub>2</sub> (coeff.)	UQ	0.99	1.06	1.16	1.09	1.10	1.10	1.22	1.26
		Me	0.61	0.58	0.61	0.57	0.69	0.65	0.59	0.61
		LQ	0.23	0.21	0.23	0.22	0.36	0.34	0.31	0.33
	Overall liquidity L <sub>3</sub> (coeff.)	UQ	1.29	1.37	1.46	1.40	1.41	1.48	1.39	1.63
		Me	0.81	0.81	0.82	0.86	1.00	0.97	0.89	1.00
		LQ	0.41	0.46	0.43	0.36	0.63	0.54	0.52	0.51
Activity indicators	Stock turnover time (days) STS	UQ	20.70	73.89	68.34	49.86	57.24	59.09	51.49	51.77
		Me	16.26	12.86	12.31	12.01	24.69	30.24	20.97	22.21
		LQ	0.00	0.00	0.00	0.00	0.27	0.00	0.00	0.00
	Short-term trade receivable payment term (days) STTRPT	UQ	79.19	73.10	80.11	60.72	98.34	84.80	81.54	78.24
		Me	34.90	32.90	29.13	25.59	44.45	46.11	48.90	31.52
		LQ	1.81	0.88	0.00	0.10	10.33	1.69	12.55	0.00
	Short-term trade liabilities payment term (days) STTLPT	UQ	147.89	124.05	124.61	85.56	113.25	123.80	109.83	97.59
		Me	45.37	38.52	42.83	31.96	50.44	51.11	45.72	40.20
		LQ	3.72	4.62	1.79	3.24	9.84	4.20	8.94	0.53
Debt indicators	Total debt against assets (%) TD/A	UQ	114.55	122.46	127.15	122.27	98.92	99.47	99.85	102.78
		Me	83.73	83.97	78.51	82.30	74.01	76.70	76.24	68.48
		LQ	54.21	44.85	44.25	45.30	39.08	42.81	38.41	30.57
	Interest coverage IC (coeff.)	UQ	1.13	1.00	1.25	2.27	1.20	1.13	1.90	2.54
		Me	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		LQ	-2.55	-2.33	-0.39	0.00	-0.96	-0.75	-0.07	0.00
	Debt flow (year) DF	UQ	9999	9999	9999	9999	9999	9999	9999	9999
		Me	53.14	26.32	20.14	14.49	25.09	31.18	18.22	11.99
		LQ	5.52	6.03	3.86	2.70	6.10	5.18	3.50	2.09
Profitability indicators	Price/earning ratio (%) P/E	UQ	0.46	0.92	1.79	2.03	0.67	0.90	1.33	2.87
		Me	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		LQ	-10.52	-8.80	-11.96	-4.22	-5.46	-4.46	-6.52	-3.07
	Return on equity (%) ROE	UQ	0.67	1.74	6.38	11.14	3.83	4.71	9.11	10.94
		Me	-9.41	-3.97	-1.68	-0.28	-1.65	-0.80	0.00	0.00
		LQ	-50.09	-41.26	-29.44	-31.85	-39.13	-31.80	-18.64	-11.11
	Return on assets (%) ROA	UQ	1.23	1.49	2.47	3.72	1.34	1.42	2.66	4.35
		Me	-2.00	-0.58	-0.11	0.00	-0.61	-0.30	0.00	0.00
		LQ	-13.01	-9.48	-9.44	-9.00	-13.28	-8.76	-6.42	-6.70

Businesses are on average extremely indebted, despite the fact that a quarter of them are able to return outside resources in an acceptable period of 4 – 5 years. There is little movement in the profitability indicators, with no signs of any great improvement.

**Production of machinery and equipment** (Table 4) is a sector that in the past held a special place in Slovakia's economy. A recovery is needed in this sector. Liquidity indicators show a movement in the desirable direction, nevertheless only in the band of average and above-average businesses. Values for the LQ have a downward trend. A significantly positive development can be seen in the case of activity indicators. Indebtedness is very high, but the ability to cover the cost of outside funds is improving in a substantial share of busi-

nesses. The result is a positive development of the profitability indicators.

**Production of electric machinery and instruments** (Table 4). This is a sector with above-average results. Its businesses have (in Slovak terms) a respectable and improving ability to cover their liabilities. Activity indicators are also developing favourably. This sector has the lowest level of debt and the upper quartile of indebtedness is in each year analysed lower than 100. Profitability indicators also have a very positive trend.

**Furniture production** is a production sector that can to a large extent utilise domestic resources. Despite this, it holds the record for adverse results. Businesses have very low liquidity; turnover indicators report only a moderate improvement. Businesses are extremely



Table 4

Years		Production of machinery and equipment				Production of electric machinery and instruments				
		1998	1999	2000	2001	1998	1999	2000	2001	
Size of set			571	619	648	554	348	399	416	345
Liquidity indicators	First degree liquidity L <sub>1</sub> (coeff.)	UQ	0.27	0.28	0.36	0.36	0.38	0.45	0.51	0.52
		Me	0.10	0.09	0.11	0.11	0.13	0.16	0.18	0.19
		LQ	0.02	0.02	0.03	0.02	0.04	0.05	0.05	0.04
	Current liquidity L <sub>2</sub> (coeff.)	UQ	1.10	1.12	1.14	1.19	1.22	1.35	1.39	1.44
		Me	0.71	0.69	0.69	0.73	0.82	0.85	0.86	0.89
		LQ	0.37	0.37	0.40	0.35	0.44	0.42	0.48	0.50
	Overall liquidity L <sub>3</sub> (coeff.)	UQ	1.45	1.47	1.52	1.52	1.47	1.79	1.68	1.78
		Me	1.00	1.00	1.00	1.01	1.09	1.09	1.08	1.14
		LQ	0.63	0.61	0.61	0.55	0.75	0.66	0.70	0.73
Activity indicators	Stock turnover time (days) STT	UQ	84.66	78.35	66.25	51.42	49.79	54.47	49.22	43.83
		Me	26.18	23.55	23.80	15.42	16.49	16.94	12.06	9.36
		LQ	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Short-term trade receivable payment term (days) STTRPT	uq	114.61	99.94	101.64	82.82	99.89	90.68	79.74	78.29
		Me	56.00	48.87	50.77	41.90	47.10	43.10	41.30	36.71
		LQ	15.75	17.84	15.52	9.82	11.81	5.67	4.62	10.22
	Short-term trade liabilities payment term (days) STTLPT	UQ	169.04	150.94	135.06	115.13	125.10	121.43	106.53	81.80
		Me	69.51	63.84	56.89	48.05	50.06	43.53	37.00	34.14
		LQ	23.32	17.25	12.66	6.65	7.78	4.46	1.87	2.67
Debt indicators	Total debt against assets (%) TD/A	UQ	100.00	101.71	105.93	102.48	94.45	95.27	95.10	96.15
		Me	79.31	81.24	81.60	79.22	72.97	72.10	72.63	71.57
		LQ	45.60	46.05	47.11	47.10	45.47	37.34	37.59	38.77
	Interest coverage (coeff.) IC	UQ	1.61	1.32	1.60	3.22	2.95	1.78	2.81	3.76
		Me	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		LQ	-0.28	-0.37	-0.11	0.00	0.00	-0.33	0.00	0.00
	Debt flow (year) DF	uq	9999	9999	9999	9999	9999	9999	9999	286.5
		Me	22.86	34.00	25.02	13.07	16.69	21.02	12.05	8.70
		LQ	6.22	6.54	5.27	3.67	4.38	4.74	3.13	2.47
Profitability indicators	Price/earning ratio (%) P/E	UQ	0.99	0.88	1.69	2.33	1.33	1.16	2.43	2.96
		Me	0.00	0.00	0.00	0.05	0.00	0.00	0.00	0.51
		LQ	-8.39	-7.33	-5.78	-1.36	-4.66	-4.89	-2.82	-0.95
	Return on equity (%) ROE	UQ	5.56	4.35	10.55	17.30	10.37	6.70	11.30	19.57
		Me	-1.86	-3.00	-1.37	0.00	0.00	-1.59	0.00	1.06
		LQ	-41.48	-36.52	-33.54	-13.49	-23.22	-31.19	-26.69	-15.08
	Return on assets (%) ROA	UQ	1.91	1.60	2.74	4.82	2.91	2.24	4.33	6.54
		Me	-0.11	-0.57	-0.24	0.14	0.00	-0.19	0.08	0.91
		LQ	-8.25	-9.38	-8.75	-4.05	-5.65	-8.15	-4.74	-3.51

burdened by debt and the value of the UQ expresses their high level of loss-making. They report only a low level of profitability and high loss-making.

**Construction** is a sector in which the majority of the figures presented are improving. With regard to the strong multiplier effect on other production sectors this is positive feature. A problematic feature, however, is the high level of debt and also the loss-making part of this set of businesses.

### Concluding evaluation

The optimism contained in the question forming the title to this article seems to be justified. Even if the rate of improvement in financial indicators as well as their

distribution differ, in several cases insignificantly (or even negatively), a positive trend nevertheless shines through. The hope for further positive development is linked in particular to businesses whose results approach those achieved as the standard in a developed market. These are numerous, comprising approximately a quarter of the total number of businesses analysed.

The now very real accession to the EU is a great chance and stimulus for further development. Our comparative advantage – a qualified and cheap workforce – will be strengthened through the significant reduction in the country's political risk. The inflow of more foreign investors is likely. Their know-how, access to markets, as well as competitive pressure will raise performance and subsequently also the financial situation of our businesses.