

## FINANCIAL PERFORMANCE ANALYSIS OF COMPANIES – SERBIAN MUNICIPALITY CASE STUDY

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### ABSTRACT

Having been in transition process towards market economy, financial analyses of companies in general, has not been performed in Serbia so far. Due to this actuality, there are no valid data concerning average values of financial indicators that would allow benchmarking and company performance trend analysis within the same economy sector. This paper represents a pioneer attempt to create application for financial analyses. Application has been tested on one selected region in our country, allowing analyses of a single company in accordance with financial indicators, as well as comparison of obtained results with benchmark and average values of industry sector and economy as a whole. The aim of this paper is to present obtained results, to point out shortcomings in financial statement inputs as well to suggest adequate measures for successful market performance of companies in Serbia.

### KEY WORDS

financial analyses, financial indicators, application

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### INTRODUCTION

The application of IFRS in Serbia Montenegro has started as a part of the overall harmonization with the regulations and practice of EU. Such a complex process indispensably includes various problems and dilemmas that have to be taken into account, settled on different levels and considered from different aspects as well. The application of unique accounting standards has enabled comparison of domestic economy with the encompassing economies as well as comparison of the enterprises of the same economy sector using various criteria. It all causes the need for the overall and adequate financial analysis of the enterprises, which has not been performed in this way in Serbia so far.

The input data used in the analysis are obtained from balance sheet, income statement, and statistical annexes of the enterprises from the Pozarevac municipality region.

### OBJECTIVES AND PROJECT SUBJECT

The aim of the project is to identify the most successful small and medium enterprises (SMEs) based on the defined groups of financial indicators in 2004.

Several key activities were performed in order to reach the defined aim of the project:

- Ø Collecting the data from balance sheet, income statement and statistical annexes of the considered enterprises;
- Ø Grouping the enterprises by the in the industry sectors;
- Ø Defining financial indicators by which further grading and selection of the most successful enterprises is to be performed;
- Ø Defining standard values of indicators;
- Ø Calculating indicators for the selected SMEs in Branicevo and Podunavlje region;
- Ø Grading the enterprises and ascertainment of ten most successful enterprises within the selected industry sector.

## METHODOLOGY

The input base comprises 2898 enterprises from Branicevo and Podunavlje region out of which 2035 enterprises represent the target of our analysis. The methodology used consists of forming and analysing of the sample, defining of financial indicators and analysis of the industry sectors according to the financial indicator along with comparison among the defined sector.

Table 1. shows industry sector according to which the enterprises are grouped together as well as the number of the enterprises belonging to each category.

Table 1. Number of enterprises for each industry sector (whole economy)

Number	Industry sector	Number of Enterprise
1.	Activities connected with real estate, renting and business activities	123
2.	Financial intermediating	5
3.	Construction	122
4.	Hotels and restaurants	49
5.	Agriculture, hunting, forestry and waterpower engineering	132
6.	Manufacturing	382
7.	Production and supply of electricity, gas and water	14
8.	Fishing	4
9.	Traffic, storage services and connections	106
10.	Wholesale and retail trade, repairing of motor vehicles	1085
11.	Mining and stone extracting	13
	<b>Total</b>	<b>2035</b>

The analysis ascertains that, compared with the number of the registered enterprises, over 70% of enterprises are in services industry. Out of the total number of the enterprises 53% belong to the wholesale and retail trade, 19% to manufacturing, 18% to agriculture, hunting, forestry and waterpower engineering, 6% to construction, 6% belong to the sector of real estate, renting and business activities, and 10% belong to other sectors.

The project defines further analysis solely in the field of small and medium enterprises in this region. By the Law on Accounting the group of small and medium enterprises may consist of the enterprises that fulfil the criteria of having the total revenue of less than €10.000.000 and the assets value less than €5.000.000. Taking into consideration the stated criteria, out of 2035 enterprises in Branicevo and Podunavlje region, 2008 enterprises belong to the group of small and medium size enterprises.

As the practice has shown that a large number of enterprises do not realize a profit out of regular activities, additional criteria for forming a final sample have been imposed. The criteria have been defined by the chronological tracking of realized revenues and net profit of the stated enterprises in this region. Consequently, the final sample consists of the enterprises with the total revenue of €8 000 (CSD 3.000.000), operating profit more than €300 (CSD 500.000) and net profit of at least 2/3 of operating profit.

Considering the previous two groups of criteria, the final sample consists of 163 small and medium size enterprises in Branicevo and Podunavlje region. Allocation of small and medium size enterprises according to previously defined sectors is shown in Table 2.

Table 2. Number of enterprises according to economy sector of SMEs

Number	Industry sector	Number of Enterprises
1	Activities connected with real estate, renting and business activities	9
2	Financial intermediating	0
3	Construction	16
4	Hotels and restaurants	0
5	Agriculture, hunting, forestry and waterpower engineering	7
6	Manufacturing	36
7	Production and supply of electricity, gas and water	1
8	Fishing	0
9	Traffic, storage services and connections	9
10	Wholesale and retail trade, repairing of motor vehicles	84
11	Mining and stone extracting	1
	<b>Total</b>	<b>163</b>

Based on the previous table it may be concluded that out of 163 enterprises over 70% is engaged in service industry sector. Out of the total number of small and medium size enterprises 52% belong to wholesale and retail trade, 22% to manufacturing, 10% to construction and the rest 16% of small and medium size enterprises belong to other activities.

For the purpose of this analysis the application has been developed. Application concludes all financial indicators and generates results for each indicator and each enterprise. Based on the large-scale analysis, one or two representative indicators have been taken out of each group. Table 3 shows groups of indicators and selected representatives.

Table 3. Selected financial indicators

	Indicators
<b>I</b>	<b>Liquidity ratios</b>
1	<b>Current ratio</b> = Current assets / Current liabilities
<b>II</b>	<b>Financial activity ratios</b>
2	Total assets turnover = Sales / Average assets
<b>III</b>	<b>Ratios of financial structure of assets and liabilities</b>
3	Debt to equity = Debt / Equity
<b>IV</b>	<b>Profitability ratios</b>
4	Net profit margin = Net profit / Sales
5	Return on equity = Net profit / Equity
<b>V</b>	<b>Thriftiness ratios</b>
6	Sales to selling expenses ratio = Sales / Selling expenses

## RESULTS

**Current ratio** measures the ability to meet short-term liabilities. It is calculated as a ratio of short term liabilities and current assets at the end of the year, in this case - 31.12.2004. Generally accepted standard is 2:1, meaning that current assets should be twice as short-term liabilities in order to ensure company's liquidity. If it is lower than 1, than means a company may not be able to pay off its bills as rapidly as it should, takes advantage of cash discounts or other favourable terms. In other words, it means that company has lost its net working capital and that a part of short-term capital has been invested in long-term investments. Average values for industry sectors for small and medium enterprises show higher level of liquidity comparing to liquidity for the economy as a whole. Values of this ratio are in the range of 1.29 to 7.92.

Table 4. Average values of current liquidity ratio for SMEs for industry sectors

Number	Industry sector	Average
1	Activities connected with real estate, renting and business activities	3.18
2	Construction	1.29
3	Agriculture, hunting, forestry and waterpower engineering	1.95
4	Manufacturing	1.82
5	Production and supply of electricity, gas and water	1.38
6	Traffic, storage services and connections	1.8
7	Wholesale and retail trade, repairing of motor vehicles	1.8
8	Mining and stone extracting	7.92

**Total assets turnover** indicates the level of sales that are generated from assets. Higher level means that more sales are generated with fewer assets, and vice versa. This ratio should be used only to compare companies within specific industry groups and in conjunction with other ratios. That is the reason why this ratio is very diversifying among different industry sectors, as shown in table 5.

Table 5. Average values of total assets turnover for SMEs for industry sectors

Number	Industry sector	Average
1	Activities connected with real estate, renting and business activities	4.5
2	Construction	2.12
3	Agriculture, hunting, forestry and waterpower engineering	2.17
4	Manufacturing	2.5
5	Production and supply of electricity, gas and water	0.72
6	Traffic, storage services and connections	3.94
7	Wholesale and retail trade, repairing of motor vehicles	2.9
8	Mining and stone extracting	1.25

**Debt to equity ratio** shows capital structure of the company. It expresses the relationship between capital contributed by the owner and the one contributed by the creditors. Lower debt than equity means greater long-term financial safety which generally means greater flexibility to borrow money. Higher ratio means that greater risk is assumed by the creditors that will pay more attention when lending money. Next table reveals the fact that there is greater participation of equity comparing to debt, indicating safety of business.

Table 6. Average values of debt to equity ratio for SMEs for industry sectors

Number	Industry sector	Average
1	Activities connected with real estate, renting and business activities	0.32
2	Construction	0.67
3	Agriculture, hunting, forestry and waterpower engineering	0.34
4	Manufacturing	0.49
5	Production and supply of electricity, gas and water	0.19
6	Traffic, storage services and connections	0.47
7	Wholesale and retail trade, repairing of motor vehicles	0.82
8	Mining and stone extracting	0.08

**Net profit margin** measures how much net profit was derived from every unit of sales. This ratio indicates whether the business is generating enough sales to cover the fix costs, and still leave acceptable profit. Average values are almost equal for SMEs as for the economy as a whole.

Table 7. Average values of net profit margin for SMEs for industry sectors

Number	Industry sector	Average%
1	Activities connected with real estate, renting and business activities	13
2	Construction	2
3	Agriculture, hunting, forestry and waterpower engineering	5
4	Manufacturing	9
5	Production and supply of electricity, gas and water	9
6	Traffic, storage services and connections	9
7	Wholesale and retail trade, repairing of motor vehicles	16
8	Mining and stone extracting	9

**Return on equity** shows profitability of equity capital. It indicates efficiency of management in gaining net profit as a return on invested capital of the owners. Average values for industry sectors for SMEs show higher level of profitability compared to the economy as a whole.

Table 8. Average values of return on equity for SMEs for industry sectors

Number	Industry sector	Average %
1	Activities connected with real estate, renting and business activities	51
2	Construction	51
3	Agriculture, hunting, forestry and waterpower engineering	18
4	Manufacturing	31
5	Production and supply of electricity, gas and water	8
6	Traffic, storage services and connections	49
7	Wholesale and retail trade, repairing of motor vehicles	45
8	Mining and stone extracting	12

**Sales to selling expenses ratio** greater than one implies that company earned operating profit, otherwise, it has operating loss. This ratio has unsatisfactory values for the economy as a

whole. More favourable values are for SMEs, because sales are greater than selling expenses giving operating profit as a result (as shown in table 9.)

Table 9. Average values of sales to selling expenses ratio for SMEs for industry sectors

Number	Industry sector	Average
1	Activities connected with real estate, renting and business activities	1.19
2	Construction	1.15
3	Agriculture, hunting, forestry and waterpower engineering	1.09
4	Manufacturing	1.1
5	Production and supply of electricity, gas and water	1.09
6	Traffic, storage services and connections	1.11
7	Wholesale and retail trade, repairing of motor vehicles	1.14
8	Mining and stone extracting	1.1

## CONCLUSION

Having in mind the fact that this large-scale analysis represents a pioneer undertaking in our country, we need to point out the fact that we have been faced with lots of obstacles in our research. One of the ground obstacles represents the input data indispensable in the financial analysis obtained from financial statements: balance sheet, income statement, and statistical annexes of the enterprises. These statements included a large number of illogical, irregular and deficient data. The most relevant ones are:

- Ø 2,5% of the enterprises did not possess the basic financial statement – balance sheet;
- Ø 37,6% of the enterprises stated zero number of employees in their statements;
- Ø There is a number of enterprises that sustained a business loss, but still had a high amount of net profit obtained from other operating incomes not based on the regular activities of the enterprises;
- Ø A large degree of inconsistency in business activities of particular enterprises was shown through financial statements so that in quite a number of cases the same enterprise has shown significantly different financial indicators value from the same group and therefore no proper evaluation of financial performance could have been made;
- Ø Within the same sector exists a large scope of ratio values so that the one ratio value varies among different enterprises for even more than a few hundred times.

The management of the related analyzed enterprises of this region were introduced with the results as well with all the problems that appeared during the research. They were signalled of the key illogical business dealings and reporting and were suggested the solutions for the overcoming of viewed deficiencies. Further steps comprise financial analysis of the enterprises from other regions that will enable further comparative analysis of the enterprises from different regions and the entire country.

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