SELF –FINANCING OF THE ENTERPRISE - INFORMATION ANALYSIS AND EVALUATION

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Abstract:
Company self-financing is done by successive accumulation of equity and is the consequence of the conclusion of several financial profit, while constituting a relevant indicator of autonomy and financial health of the company.

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JEL classification: G, G01, G02

The company's net profit is a fundamental indicator for the performance analysis of the general activity and its evolution in time influences the company's capacity to make new investments, to reimburse its contracted debts and to pay correspondingly the capital assigned by shareholders. Although absolutely influenced by the amortization policy of the company or by elements of fiscal policy[104], the net result has the merit to constitute the foundation stone of self-financing capacity of the company for the next financial year.

Far from claiming to be an exhaustive research within the financial analysis perimeter, the present work sets as objective to present the special importance of self-financing capacity of the company to establish a good financial diagnosis for companies.

The purpose of the present work is to emphasize the role and use of information supplied by self-financing capacity which represents a personal resource which can be used taking into consideration the objectives set by management.

The self-financing capacity of a company reflects its potential to sustain its activity from own financial resources on the multiple levels on which it develops its activity (production, merchandising, investments). As far as the company's activity is profitable, it appears a growth of the self-financing potential, the company disposing of resources for the distribution of dividends to shareholders, to make the replacement investments (on behalf of the amortization imputed to the financial year result) and of developement resources (by reinvested net profit).

In the specialty literature[105], there are presented two calculation ways of the self-financing capacity – additive method (additional) and deductive method, which we will describe further.

Additive method (additional) determins the self-financing capacity on the basis of calculated incomes and expenses which affect the financial year result, but not the company's treasury. According to this method, we start from the net profit (or net loss), to which we add the calculated expenses and from which we diminish the calculated incomes:

[104] This is the reason why some authors don't recommend the use of net profit as reference for the comparison of companies performances.
[105] To see Stancu (2007), pag. 728 – 730 and Vintilă (2005), pag. 92 – 95.

$$CAF = PN + CC - VC \qquad (1),$$

where:

CAF = self-financing capacity of the company generated by the activity developed during the financial year;

CC = calculated expenses (for example, those with amortizations and calculated provisions);

VC = calculated incomes (for example, incomes from resumptions upon amortizations and provisions).

The additive method of CAF determination is based upon the premise that the financial year net result doesn't reflect but partially the potential resources which can be used by company in view of self-financing. As Helfert (2001)[106] shows, it is necessary the addition of calculated expenses because the amortization of fixed assets represents the distribution of past expenses in many ulterior financial years and doesn't diminish directly the monetary flows of the considered period, but only indirectly, by diminution of the profit tax due to State[107]; provisions expenses are in the same situation because they practically represent amounts which the company "immobilize" in order to honour some future uncertain commitments as production, size and moment of appearance. However, this tax economy generated by the acknowledgement of amortization and provisions when establishing the taxable profit, has been already passed for the CAF determination, taking into consideration that the net result has represented the starting point for its calculation[108]. In case of calculated incomes, we proceed inversely: these are not taken into consideration because they have been already incorporated in the net result or they don't represent real cash inflows which determin the treasury's growth and implicitly of self-financing capacity.

Deductive method of CAF calculation, as its designation suggets, proposes a way in the opposite direction to the one presented for the additive method. Thus, we start from the gross operating surplus to which we add other retrievable incomes and payable expenses:

$$CAF = EBE + AVI - ACP \qquad (2),$$

where:

AVI = other retrievable incomes (operating, financial, extraordinary);

ACP = other payable expenses (operating, financial, extraordinary).

Determination of self-financing capacity on the basis of deductive method supposes the indicator's determination on the basis of retrievable incomes and payable expenses, fact which determined some authors to consider CAF as an indicator similar to cash flow[109].

The company's self-financing capacity represents the global monetary accumulation which the company generates through its activity and can use it as we previously showed, for its own capital remuneration (through dividends) and for investments in productive capital or in other companies' assets. If we diminish from CAF the value of dividends assigned to shareholders , we obtain *global self-financing* (AFG):

$$AFG = CAF - DIV \qquad (3)$$

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[106] Pag. 84 – 85.

[107] Diminution of due taxes is the reason for which many companies prefer the use of accelerated depreciation (which supposes a bigger depreciation in the first years of the asset use) in relation to the proportional classical method. For additional details, please see Brigham and Ehrhardt (2002), pag. 301.

[108] Helfert (2001), pag. 84, notifies us that it would be a big mistake to consider amortization and provisions as available cash (after their consideration with plus sign for the calculation of self-financing capacity); they are not but accounting recordings which diminish the financial year result and implicitly produce an artificial decrease of the real cash flow of the period.

[109] According to Stancu (2007), pag. 728.

In its turn, global self-financing composes of *maintenance self-financing* (AFM) and *net self-financing or of development* (AFD):

$$AFG = AFM + AFD \qquad (4)$$

Maintenance self-financing represents that part from gross self-financing meant to renew the production capacities (through the frozen assets amortization) and cover the risks encountered by the company

(operating, financial or extraordinary) which is achieved by means of provisions. Thus, maintenance self-financing has the purpose to conserve the patrimony value of the companyand at the same time to provide the resources necessary for the achievement of company's duties which are conditioned by the occurrence of some events. We can consider the maintenance self-financing as an insurance policy against the risk of patrimony diminution of the company.

Development self-financing (or net self-financing) is the component of global self-financing which expresses the future development possibilities of the company (growth of its patrimony value) by its own forces (without appealing to external capital sources). The main source which supplies the development self-financing is the part from the net profit which the company capitalizes (which remains after the dividends distribution and/or after the coverage of eventual losses from previous financial years).

The case study in which we intend to use the concepts presented in real cases of companies will be done to the S.C. SIGMA S.A company. Before starting the respective study, we consider that it is important to reiterate the fact that the analysis of self-financing capacity to S.C. SIGMA S.A. doesn't have to be considered as a purpose in itself. It is but a simple instrument at the hands of managers and which should help them to make the best informed decisions.

Now, we will pass to the the calculation of the self-financing capacity for SIGMA S.A. The calculation method used will be the deductive method since it allows us to emphasize the contribution of results from the three activities of the company (operating, financial and extraordinary) up to its self-financing capacity[110].

The situation of S.C. SIGMA S.A. is presented in the following table:

YEAR	2009	2010	2011	2012
Gross operating surplus (GOS)	57.502.684	1.490.229	34.170.341	259.872.583
Other retrievable operational revenues (OROR)	0	0	0	0
Other payable operating expenses (OPOE)	0	0	0	0
Retrievable financial revenues (RFR)	19.934.944	38.782.594	92.301.309	57.725.843
Payable financial expenses (PFE)	31.564.179	28.110.843	42.285.556	65.589.326
Retrievable extraordinary revenues (REV)	0	0	0	0
Payable financial expenses (PFE)	0	0	0	0
Self-financing capacity (SFC)	45.873.449	12.161.980	84.186.094	252.009.100
Net result of the period (NRP)	17.173.683	-1.036.756	55.614.476	50.540.752

Table 1. *Self-financing capacity of S.C. SIGMA S.A. within the period 2009 – 2012 (calculated through the deductive method)*

Source: profit and loss accounts from 2009 – 2012 of SIGMA S.A., own calculation. The sums are expressed in RON.

[110] Yet, we should bear in mind that not only the deductive method but also the additive method produce the the same result.

Interpretations

The evolution of self-financing capacity of SIGMA can be estimated as being favourable, taking into consideration that the company succeeded even in 2010 when it ended with loss, to ensure through amortizations, provisions and its financial activity a positive self-financing (of 12,16 mil. RON, of about eight times higher than the gross operating surplus). In 2009, self-financing had a much higher value (of 45,87 mil. RON), as a result of the consistent profit from the operating activity (GOS = 57,50 mil. RON), which compensated for the registered financial loss of 11,63 mil. RON. It is noticeable the fact that self-financing represented about 80% from GOS this year and 7% from the turnover despite the negative result of the financial period.

In 2011 it was a different story: the very good operating result (GOS = 34,17 mil. RON) interweaved with the exceptional financial profit realised (of over 50 mil. RON), which allowed for the release of a self-financing capacity of 84,19 mil. RON, which means that the company preserved for self-financing more than the double of the gross operating surplus and at the same time over 10% from the net turnover!

In 2012, the self-financing capacity of SIGMA registered the best value of 252,01 mil. RON, set up integrally on the operating activity of the company (the financial activity ending with loss).

The reasons for which the self-financing capacity has a great importance for the company's financial management are the following: first of all, it is about the fact that self-financing represents a personal constant resource at the company's disposal which can be used depending of objectives indicated by the management (distribution of dividends, realization of developement investments etc.), as opposed to borrowed financial resources which many times have a pre-established destination. Self-financing appears as a guarantee of the company's financial autonomy which can avoid therefore the dependence on borrowed resources.

At the same time, a good self-financing capacity implies the diminution of the company's indebtedness with beneficial effects upon its rentability[111] (through diminution of interest expenses), but also upon the insolvency risk (in the sense of its diminution). Moreover, a high potential of self-financing facilitates the company's access to new capital (through bank credit, issue of shares or noteholder credit), CAF representing an indicator analysed with interest not only by the company's creditors but also by the investors interested to purchase its shares. Yet, borrowed resources must be regarded as a complement and not as a substitute of own resources represented by self-financing[112].

The company's self-financing is achieved through consecutive accumulation of own capitals and it is the consequence of profit closing of many financial years, representing at the same time a relevant indicator for the autonomy and financial health of the company.

The financial activity of a company must be planned very carefully since it implies considerable risks; managers of performant companies can be tempted by investments with high potential rentability but also with high associated risks which can generate serious problems for the company under the aspect of liquidity and even of solvency. Thus, it is recommended the elaboration of a financial investments policy which ensures the risks'dispersion (and in extenso, finding the rentability-risk compromise) and which is based on a good knowledge of financial markets situation. At the same time, the financing decision must ensure the getting of the lowest possible cost

[111] Here, things are not quite clear, because we can argue with some reason that the indebtedness diminution reduces also the lever effect upon the company.

[112] According to Vintilă (2005), pag. 97.

of the borrowed capital and a balanced structure of the borrowed capital under the aspect of its exigibility[113].

In view of reliability growth of financial analysis, we recommend the treatment with some reserves of the company's financial year. Although this can have an important impact upon the company's profitability, yet the base of company's earnings must be represented by its operating activity because this groups the operations which the economic entity develops currently in view of profit obtainment. Thus, we consider that a profit resulted from the corroboration of an operating loss (or even of a reduced gain) with an important gain from financial activity is less qualitative than even the same profit resulted after a good operating rentability and a bad financial result.

The last intermediary management balance, the net profit, represents the most used indicator (in absolute figures) for the rentability assessment of the company and at the same time constitutes the fundamental source on which is based the self-financing capacity of the company. The last one is an important indicator regarding the company's ability to finance itself from own sources in the future and to increase its financial autonomy.

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[113] It is essentially about the arbitrage between long-term financing and short-term financing.