FINANCING CAPACITY, AN INDICATOR OF SELF FINANCING FOR COMPANIES

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In the introduction of this paper the research objectives are presented on a case study, the research method, as well as the literature in the field and the novelty of this study. Furthermore, several aspects on the source of information for determining intermediate management balances are covered. In the third part of the study the indicator of self-financing capacity of companies is determined. The correlation between the self-financing capacity and term debts are shown in the fourth part and the fifth part of this study presents some aspects regarding global self-financing, maintaining self-financing, net self-financing, and finally the results of the study are presented.

Keywords: profit and loss account, intermediate management balances, self-financing capacity, correlation

JEL Code: M41, F65, G17

1. Introduction

The aim set in this study is to determine the self-financing capacity of economic entities, the main indicator of internal source of maintaining for economic entities based on a case study carried out for five years within a company, as well as to correlate this indicator with term debts of the company.

The research method used is observation, documentation, financial analysis, comparing data during the studied period of time.

The novelty of this study consists in establishing the self-financing ratio of the companies included in a case study, aiming to measure the efficient use of internal financing resources and seeking external funding only if needed. The study is divided into five parts: profit and loss account as a source for measuring the economic entities' performance, intermediate management balances, self-financing capacity as the main indicator of internal source of funding, the correlation between the self-financing capacity and debts maturity, global self-financing, maintenance self-financing, net self-financing and finally the study results.

The scientific literature approached during the research is presented at the end of the study.

2. Profit and loss account as a source for determining the economic entity's performance

The structure of legal persons' financial statements is regulated in Romania by OMPF No. 3055/2009 and include: balance sheet, income statement, equity changes statement, cash flow statement, notes to the annual financial statements for those that meet the three criteria of size (total assets, net turnover, number of employees) or simplified annual financial statements for legal entities that, on the balance sheet date do not exceed the limits of two of the established size criteria (article 3, paragraph (1) and (2)).

For this case study we used the profit and loss account of the Albalact[38] company during 2008, 2009, 2010, 2011, 2012. The layout of the profit and loss account is presented in Appendix no. 1.

After analysing the main indicators of the profit and loss account in Appendix 1, one may see that:
- the net turnover during the analised period increased from year to year being 1.80 times higher in 2012 than in 2008 as a result of the investment policy of Albalact company
- the operating profit of 2012 was 1.415 times higher than in 2008, as a result of the investment policy, recording the lowest level in 2010, due to lack of raw materials.

[38] wwwbvb.ro, albalact.ro.

- taking into account its financing activity, the company recorded losses, increasing from year to year, except for 2009 when they increased by 13.20% compared to 2008, in 2012 being 29.71% of those in 2008.
- net profit increased every year except for 2010, reaching 7320697 lei in 2012.

3. Intermediate management balances in the period 2008-2012

The following lines display the calculation and meaning of intermediate management balances[39]. Based on the profit and loss account layout in which income and expenditure are divided into operating, financial and extraordinary activities, one may calculate the following indicators:

1. **Commercial margin** (cm) = Sales of goods - Discounts on sales - Cost of the goods.

This is the main indicator of the activity of trade companies.

2. **Turnover** (T) = Revenue from sale of goods + sold production

3. **Production of the year** (PE) = sold production + income from the stored production + income from the production of property

This indicator reflects the companies´ activity more than its turnover.

4. **Added value** (AV) = production of the year + Revenue from sale of goods - Consumption of goods and services provided by third parties for the production

where

Consumption of goods and services = Costs of raw materials *+ total material costs + expenditure for works and services provided by third parties.*

Gross added value expresses a creation of value or increase of the value the company brings to the third-origined goods and services in operating its current professional activity[40].

5. **Gross operating surplus** (GOS) = Added value + operating subsidies - taxes, fees and assimilated payments - personnel expenditure

Gross operating surplus measures the company ´s economic performance; it is independent of financial policy "broadly" promoted by the company (independently of the company´s financial nature, regardless of the setting of linear, progressive, or degressive depreciation and independently of the decisions taken on the distribution of dividends[41])

6. **Operating profit** (OP) = GOS + (income from depreciation and provisions + other operating income) - (Expenditure for depreciation and provisions for operation + Other operating costs).

This indicator shows the exploitation profit, independently of financial, tax and dividend distribution policy, taking into account only the consumption of fixed capital (depreciation).

7. **Current profit before tax** (CP) = GOS + Financial income - financial charges.

This indicator expresses the result of the company's current activity.

8. **Extraordinary profit** (Pe) = Extraordinary income - Extraordinary expenditure.

This indicator shows the profit or loss derived from extraordinary activities.

9. **Net profit or loss**

This indicator expresses the gross profit or loss after deducting income tax.

The intermediate management balance is calculated in the following chart:

Chart no. 1. Calculation of intermediate management balances *in the period 2008-2012*

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No.		2008	2009	2010	2011	2012
	A					
1	Net turnover	190.546.810	225.975.200	261.256.670	338.250.651	343.844.878
	Income production cost under execution (ct.711+712)					
2	Balance C	9.640.132			1.808.733	390.407
2	Balance D		763.519	360.324		
3	*Production performed by the entity for its own purposes and capitalized* (ct.721+ 722)	101.412	886.617	1.628	29.682	
4	Production of the year (1+2+3)	200.288.354	226.098.298	260.897.974	340.089.066	344.235.285
5	Other operating income (ct.758+7417+7815)	3.625.518	6.475.539	3.443.126	7.769.317	464.114

[39] Hada Teodor, *Finances of Economic Agents in Romania*, Intelcredo Publishing House, Deva, 1999, pp. 173-174.
[40] Petre Brezeanu, *Corporate Finance*, Vol. 1, C. H. Beck Publishing House, 2008, p. 133.
[41] Petre Brezeanu, *CorporateFinance*, Vol. 1, C. H. Beck Publishing House, 2008, pp. 138-139.

No.		2008	2009	2010	2011	2012
6	OPERATING INCOME - TOTAL	203.913.872	232.573.837	264.341.100	347.858.383	344.699.399
7	Costs of *raw materials and consumables* (ct.601+602-7412)	120.169.828	135.219.191	151.977.696	202.971.507	199.555.303
8	Other material charges (ct.603+604+606+608)	573.476	509.005	719.050	1.590.481	702.646
9	Other external costs (energy and water)(ct.605-7413)	3.798.937	4.279.072	4.477.543	5.002.213	5.172.503
10	*Expenditure on external services*	35.078.045	35.428.849	43.535.261	55.248.544	54.971.783
11	*Cost of goods* (ct.607) - *Received trade discounts* (ct. 609)	3.115.475	4.040.429	20.431.714	31.087.188	27.328.704
12	Other expenditure (ct.652+658)	2.009.052	4.868.567	763.285	1.114.330	2.814.297
13	Added value(4-(7+8+9+10+11))	37.552.593	46.621.752	39.756.710	44.189.133	56.504.346
14	*Personnel expenses*	19.815.236	21.852.040	23.582.203	28.597.188	29.989.472
15	*Other taxes, fees and assimilated payments* (ct.635)	959.536	969.733	1.250.675	1.001.145	902.746
16	GOS 13-(14+15)	16.777.821	23.799.979	14.923.832	14.590.800	25.612.128
17	*Value adjustments on* current assets	283.784	2.148.359	-317.731	15.833	-22.649
18	*Value adjustments on tangible and intangible assets*	10.522.355	12.813.615	13.459.848	11.743.782	12.544.956
19	*Operating profit* (16+5-(17+18+12))	7.588.148	10.444.977	4.461.556	9.486.172	10.739.638
20	Financial profit	-6.748.518	-7.639.045	-3.284.105	-2.677.258	-2.005.145
21	Current profit	839.630	2.805.932	1.177.451	6.808.914	8.734.493
22	Profit extraordinary	0	0	0	0	0
23	Gross profit	839.630	2.805.932	1.177.451	6.808.914	8.734.493
24	Income tax	233.051	202.153	597.239	1.041.430	1.413.796
25	Net profit	606.579	2.603.779	580.212	5.767.484	7.320.697

Source: Performed by the author.

After analysing the main information contained in the table above, one may see that:
- the production of the year increased from year to year being 1.72 times higher in 2012 than in 2008.
- the added value increased from year to year except for 2010, being with 50.47% higher in 2012 than in 2008.
- Gross operating surplus recorded in 2012 an increase of 52.65% compared to 2008.

4. Self-financing capacity in the period 2008-2012

4.1. Definitions of self-financing capacity[42]

The most important thing for a company is to dispose of internal resources of funding in time and in sufficient amount to be able to operate normally.

The advantage of using internal resources of funding is given by:
- the low financing costs, as these sources seem to be "free" at a first sight;
- money market has not always sufficient sources of funding;
- saving time (using external sources of financing and fulfilling the necessary formalities sometimes last very long).

The internal resources are also a barometer of effective use of capitals, encouraging judicious usage of resources available to the companies.

The indicator reflecting the financial potential determined by the company's profitable activity at the end of a period, intended to remunerate equity (in dividends) and to fund future development (the

[42] Hada Teodor, *Finances of Economic Agents in Romania*, Intelcredo Publishing House, Deva, 1999, pp. 175-176.

share of profits intended for own sources and reserve fund) and to maintain or renew fixed assets (by depreciation) is self-financing capacity. Also, self-financing capacity represents a potential global net cash flow[43] uninfluenced by assets disposed, operating and financial depreciations and provisions.

Self-financing capacity (SFC) is established by two methods:
- deductive method;
- additional method.

Using the deductive method, self-financing capacity is calculated as the difference between the income receivable (corresponding to actual or future revenue) and expenses payable (corresponding to actual or future payments).

As a starting point in determining the self-financing capacity is the operating gross surplus (cash potential surplus) to which one adds all income likely to be received (operational, financial, exceptional) and subtracts all costs likely to be paid.

SFC = (Revenue receivable - Income from disposals) - Expenses payable
SFC = GOS + other income receivable except income from disposals - Other expenses payable.

For example, considering the elements of the profit and loss account layout:
SFC = gross operating surplus + Other operating income – Other operating expenditure + Financial income (1) - Financial expenses (2) + Extraordinary income (3) - Extraordinary expenditure (4) - Income tax
where:
1 - no reversals on provisions
2 - no financial depreciation and provisions calculated
3 - without:
- income from the sale of assets
- aliquot subsidies paid on earning year
- reversals of extraordinary provisions
4 - without:
- net carrying amount of assets disposed
- extraordinary depreciation and provisions calculated

4.2. Self-financing capacity *in the period 2008-2012*

The calculation of the self-financing capacity is presented in the chart below.

Chart 2. Calculation of the self-financing capacity in the period 2008-2012

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No.	Indicators	2008	2009	2010	2011	2012
1	SFC by deductive method: 2+3-4+5+6-7	11412718	17565753	13722329	17527099	19843004
2	GOS	16777821	23799979	14923832	14590800	25612128
3	Other operating income	3625518	6475539	3443126	7769317	464114
4	Other operating expenditure	2009052	4868567	763285	1114330	2814297
5	Financial profit	-6748518	-7639045	-3284105	-2677258	-2005145
6	Extraordinary profit	-	-	-	-	-
7	Income tax	233051	202153	597239	1041430	1413796
8	SFC by additional method: 9+10+11	11412718	17592753	13722329	17527099	19843004
9	Net profit	606579	2603779	580212	5767484	7320697
10	*Adjustments and provisions on fixed assets*	10522355	12813615	13459848	11743782	12544956
11	*Adjustments and provisions on current assets*	283784	2148359	-317731	15833	-22649

Source: Performed by the author.

[43] Bărbuţă-Mişu Nicoleta, *Financial Performance Evolutions of Textile Sector Enterprises*, Annals of "Dunărea de Jos" University of Galati, Fascicle I, Economics and Applied Informatics, Vol. 11, Issue 1, 2005, pp. 75-80.

From the data presented above one may observe that the Albalact company increased its self-financing capacity with 73.87% in 2012 compared to 2008, its lowest level being registered in 2010. By the level recorded, the company may remunerate its own equity, to fund future development and to maintain or renew fixed assets.

5. Correlation between term debts and self-financing capacity

To indebt, banks require the compliance with certain limits. In the case of long- and medium-term requirements, the condition needed to be met is that the debt should not exceed a certain multiple of the self-financing capacity.

$$\frac{Term\ debts}{Self - financing\ capacity} \leq 4$$

The higher the self-financing capacity, the more the possibility of resorting to loans increases. Loans, under these conditions, represent a positive factor for the company, the bank interest being covered by the return obtained, the company still having a profit that may be used to pay *the factors of production, state taxes*, etc[44].

The correlation between term debts and the self-finance capacity are presented in the following chart:

Chart No. 3. Correlation between term debts and the self-financing capacity

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No.	Indicator	2008	2009	2010	2011	2012
1	Debts > 1 year[45]	35235629	36347454	29050270	31235334	22246828
2	SFC	11412718	17565753	13722329	17527099	19843004
3	$\frac{\text{term debts}}{\text{SFC}} \leq 4$ (1:2)	3,09	2,07	2,12	1,78	1,12

Source: Performed by the author.

The above data show that the Albalact company was within normal limits of correlation, recording its best level in 2012.

6. Global self-financing, maintenance self-financing, net self-financing

Among the components of the self-financing capacity, there are certain connections established. Thus, depreciation has a neutral impact on self-financing: increasing depreciation costs, profits lower, and vice versa, so one cannot count on another self-financing amount of resources than that which operation could generate.

So companies apply methods aiming to increase the amount of depreciation (accelerated method, the diminishing balance method), although the profit earned by them and the profit distributions to equity are lower.

Likewise, the self-financing policy and the policy of profit distribution are closely connected. Granting higher or lower dividends - directly influences- the amount of own funds and therefore, the self-financing. While during the transition, in the case of state-owned companies the profit distributions are established by law, in the case of private-capital companies these are established by the general meeting of shareholders. In these companies the profit, either distributed as dividends or used for development, is the property of the shareholders. Therefore, the profit distribution policy is ultimately a liquidity policy: the existence of equity leads to the growth of the company´s liquidity and thus the possibilities for self-financing increase. Higher dividend distributions lead to decreasing liquidity and thus the company's ability to finance itself decreases.

But in fact, the entire capacity of self-financing does not remain available to the company. If the dividends and employees' profit participation (in our country *there is a distribution of profits*) are deducted from the self-financing capacity, global self-financing (total) is obtained.

Therefore :

Global self-financing = self-financing capacity - Dividends distributed – employees´ participation in profits – share of managers.

Global self-financing has two components:

[44] Hada Teodor, *Finances of Economic Agents in Romania*, Intelcredo Publishing House, Deva, 1999, p. 177.
[45] wwwbvb.ro, albalact.ro

- maintaining self-financing;
- net self-financing.

Maintaining self-financing includes the sources *to ensure future expenses* to be carried out to maintain and develop their productive potential. The main component of the maintaining self-financing is maintenance to which depreciation and provisions are added. The net self-financing is the part of the gross self-financing out of which the company's own sources are formed, over the requisites demanded to restore the invested capital, leading to an increase in property, so:

Net self-financing[46] = Gross self financing - expenses for maintaining the productive potential (depreciation expense)

and it is also equal to the distribution of reserve fund plus allocation of own funds (former development fund).

In the case of Albalact only in 2012, the General Meeting of Shareholders provided distributions of profits to dividends, during the other years the self-financing capacity contributed to the company funding.

7. Conclusions

The data presented above show that Albalact Trading Company recorded a financing capacity falling within the normal correlation. The company is also able to pay the dividend to shareholders out of internal resources.

For its development, the company may use amortization as internal source of financing, as well as the share of profits remaining after having made payments to the participants involved in the company´s activity.

By the way, it used its internal and external sources of funding in 2012, Albalact became the fifth dairy producer in Romania.

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Appendix

PROFIT AND LOSS ACCOUNT IN THE PERIOD 2008-2012

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	rd.	2008	2009	2010	2011	2012
A	B					
1. *Net Turnover* (rd. 02+03-04+05+06)	1	190.546.810	225.975.200	261.256.670	338.250.651	343.844.878
Sold Production (ct.701+702+703+704+705+706+708)	2	186.297.348	220.840.466	242.974.403	311.041.255	327.453.946
Revenue from sale of goods (ct. 707)	3	4.249.462	5.134.734	29.457.497	42.205.893	36.393.240
Trade discounts granted (ct. 709)	4	0	0	11.175.230	14.996.497	20.002.308
Interest income *registered by entities removed from the General Register* and still having ongoing lease contracts (ct.766*)	5	0	0	0	0	0
Income from subsidies related to net turnover (ct.7411)	6					
2. *Income production cost under execution* (ct.711+712)						
Balance C	7	9.640.132			1.808.733	390.407
Balance D	8		763.519	360.324		
3. *Production performed by the entity for its own purposes and capitalized* (ct.721+ 722)	9	101.412	886.617	1.628	29.682	
4. *Other operating income* (ct.758+7417+7815)	10	3.625.518	6.475.539	3.443.126	7.769.317	464.114
- *of which income from negative goodwill*	11					
OPERATING INCOME - TOTAL (rd. 01+ 07 - 08 +	12	203.913.872	232.573.837	264.341.100	347.858.383	344.699.399

[46] Hada Teodor, *Finances of Economic Agents in Romania*, Intelcredo Publishing House, Deva, 1999, pages 177, 178

	rd.	2008	2009	2010	2011	2012
A	B					
09 + 10)						
5. a) Costs of *raw materials and consumables* (ct.601+602-7412)	13	120.169.828	135.219.191	151.977.696	202.971.507	199.555.303
Other operating charges (ct.603+604+606+608)	14	573.476	509.005	719.050	1.590.481	702.646
b) *Other external charges* (*energy and water*)(ct.605-7413)	15	3.798.937	4.279.072	4.477.543	5.002.213	5.172.503
c) *Costs of commodities* (ct.607)	16	3.115.475	4.040.429	20.559.415	31.248.873	27.548.500
Trade discounts received (ct. 609)	17			127.701	161.685	219.796
6. *Personnel expenses* (rd. 19 +20)	18	19.815.236	21.852.040	23.582.203	28.597.188	29.989.472
a) *Wages and salaries* (ct.641+642+643+644-7414)	19	15.631.791	17.197.248	18.390.863	22.402.331	23.476.201
b) Social security and social protection costs (ct.645-7415)	20	4.183.445	4.654.792	5.191.340	6.194.857	6.513.271
7.a) *Value adjustments on tangible and intangible assets* (rd. 22 - 23)	21	10.522.355	12.813.615	13.459.848	11.743.782	12.544.956
a.1) Expenditure (ct.6811+6813)	22	10.522.355	12.813.615	13.459.848	11.743.782	12.544.956
a.2) Income (ct.7813)	23					
b) *Adjustment of current assets* (rd. 25 - 26)	24	283.784	2.148.359	-317.731	15.833	-22.649
b.1) Expenditure (ct.654+6814)	25	283.784	2.482.907	534.285	133.695	193.848
b.2) Income (ct.754+7814)	26		334.548	852.016	117.862	216.497
8. *Other operating charges* (rd. 28 la 31)	27	38.046.633	41.267.149	45.549.221	57.364.019	58.688.826
8.1. Costs of *external services* (ct.611+612+613+614+621+622+623+624+625+626+627+628-7416)	28	35.078.045	35.428.849	43.535.261	55.248.544	54.971.783
8.2. *Other taxes, fees and assimilated payments* (ct.635)	29	959.536	969.733	1.250.675	1.001.145	902.746
8.3. Other costs (ct.652+658)	30	2.009.052	4.868.567	763.285	1.114.330	2.814.297
Interest expense from refinancing registered by entities removed from the General Register and still having ongoing lease contracts (ct.666*)	31					
Adjustments for provisions (rd. 33 - 34)	32					
- Expenditure (ct.6812)	33					
- Income (ct.7812)	34					
OPERATING EXPENDITURE - TOTAL (rd. 13 la 16 - 17 +18 + 21 + 24 + 27 + 32)	35	196.325.724	222.128.860	259.879.544	338.372.211	333.959.761
OPERATING PROFIT OR LOSS:						
- Profit (rd. 12 - 35)	36	7.588.148	10.444.977	4.461.556	9.486.172	10.739.638
- Loss (rd. 35 - 12)	37			0	0	0
9. Income from equity interests (ct.7611+7613)	38					
- *of which revenues from affiliates*	39					
10. *Income from other investments and loans forming part of the assets* (ct.763)	40					
- *of which revenues from affiliates*	41					
11. *Interest income* (ct.766*)	42	707.766	156.433	49.577	43.347	85.639
- *of which revenues from affiliates*	43					
Other financial income (ct.762+764+765+767+768)	44	1.672.991	1.978.819	4.887.019	5.221.388	5.590.341
FINANCIAL INCOME- TOTAL (rd. 38 + 40 + 42 + 44)	45	2.380.757	2.135.252	4.936.596	5.264.735	5.675.980
12. *Value adjustments on financial assets and financial investments held as current assets* (rd. 47 - 48)	46					
- Expenditure (ct.686)	47					
- Income (ct.786)	48					
13. *Interest expense* (ct.666*-7418)	49	2.902.536	3.362.176	2.294.799	2.237.891	1.674.000
- of which charges related to *affiliates*	50					
Other financial expenses (ct.663+664+665+667+668)	51	6.226.739	6.412.121	5.925.902	5.704.102	6.007.125
FINANCIAL EXPENSES - TOTAL (rd. 46 + 49 + 51)	52	9.129.275	9.774.297	8.220.701	7.941.993	7.681.125
FINANCIAL PROFIT OR LOSS:						
- Profit (rd. 45 - 52)	53			0	0	0
- Loss (rd. 52 - 45)	54	6.748.518	7.639.045	3.284.105	2.677.258	2.005.145
14. CURRENT PROFIT OR LOSS:						
- Profit (rd. 12 + 45 - 35 - 52)	55	839.630	2.805.932	1.177.451	6.808.914	8.734.493
- Loss (rd. 35 + 52 - 12 - 45)	56			0	0	0

	rd.	2008	2009	2010	2011	2012
A	B					
15. Extraordinary income (ct.771)	57					
16. Extraordinary expenditure (ct.671)	58					
17. PROFIT OR LOSS OF EXTRAORDINARY ACTIVITY:						
- Profit (rd. 57 - 58)	59			0	0	0
- Loss (rd. 58 - 57)	60			0	0	0
TOTAL INCOME (rd. 12 + 45 + 57)	61	206.294.629	234.709.089	269.277.696	353.123.118	350.375.379
TOTAL EXPENDITURE (rd. 35 + 52 + 58)	62	205.454.999	231.903.157	268.100.245	346.314.204	341.640.886
GROSS PROFIT OR LOSS:						
- Profit (rd. 61 - 62)	63	839.630	2.805.932	1.177.451	6.808.914	8.734.493
- Loss (rd. 62 - 61)	64			0	0	0
18. Income tax (ct.691)	65	233.051	202.153	597.239	1.041.430	1.413.796
19 Other taxes not mentioned above (ct.698)	66					
20. NET PROFIT OR LOSS FOR THE FINANCIAL YEAR:						
- Profit (rd. 63 - 64 - 65 - 66)	67	606.579	2.603.779	580.212	5.767.484	7.320.697
- Loss (rd. 64 + 65 + 66 - 63)	68			0	0	0
Checksum F20 : 5198345441 / 10577157572						

Source: Annual Financial Reports of the Albalact Company in the period 2008-2012.