

The Analysis of Equity Capital of an Economic Entity in Romania

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Abstract

Regarding the complexity of the problems that society is facing today, the need for some ways to approach and analyse the phenomena, capable of ensuring a dynamic between micro and macro societal level interests, as well as the need for operational action solutions, based on a well-founded management on sustainable development models, able to face the new demands imposed by the competition of innovative economies led us this research. The current dimensions of the equity sources and its impact on enterprises acquire new values in their sustainable operation, and the assessment of own capital serves as the basis for calculating the indicators that characterize the financial state of enterprises. Therefore, the authors intend to develop an equity analysis on the example of S.C. AS Construct SRL Ilfov S.R.L, using both the 2019-2021 financial statements and the comparative analysis. The paper ends with the authors' conclusions regarding the possibilities of increasing the efficiency of the use of own capital by economic entities.

Key words: analysis of the financial-property situation, equity, economic entity

J.E.L. classification: M21, M49

1. Introduction

The evolution of today's society is characterized by a new visionary context, promoting ideas aimed at shaping a more attractive future, in which people move from the current mentality to a social, economic, cultural, spiritual, and technological evolution - aimed at converging towards well-being population and the health of the planet. In recent years, economic entities have constituted the basic pillar of the economy for EU member states, representing the key sector for the country's economic growth and sustainable development. As a result of the restructuring of the economy, economic entities contributed to the absorption and creation of a considerable number of jobs, generating a strong impact on the process of adapting production to the new market requirements.

Without the existence of resources and the means that generate the resources, the efficient and systematic operation of an economic entity is unlikely. For its financial sustainability, the essential element is capital. The concept of capital, along with the development of economic thinking, was assigned concrete meanings and approaches, corresponding to the dominant paradigms of economic analysis in the development of society.

In the market economy, the company's financial policy is the key to increasing its financial potential, the indicators characterizing its financial condition being based on the valuation of its equity. (Dura et al., 2012, p.73). Equity analysis is the basis for identifying the primary components and determining the consequences of their changes on the company's financial stability. The dynamics of changes in equity determine the volume of borrowed and attracted capital.

The problem that must be identified with priority by an economic entity is the source of monetary capital for financial activities, ensuring the circulation of money and creating the conditions for its economic growth. In the process of economic activity, there is a constant rotation of capital through the prism of the fact that, successively, the monetary form changes into the material one, which in turn changes by taking various forms, according to the conditions of production and the activity carried out by each individual economic entity, so that in the end, the capital turns back into money.

Therefore, capital is the means owned by an economic entity to carry out economic activities, with the obvious purpose of obtaining profit.

Any investor, regardless of the activity he carries out or the form of ownership, aims to obtain the highest possible profits and to keep the economic entity on the market for as long as possible (Stancu *et al*, 2020, p.59). For having a clear picture of the value of the economic entity, it is absolutely necessary to draw up annual financial statements and periodic accounting reports. To identify the most significant indicators that characterize the financial activity of an economic entity, the data from the accounting balance are used.

Based on the elaborated reports, certain indicators can be determined, the structure ratios can be calculated, and the financial-property structure of the respective entity can be determined, highlighting its state of financial balance (Răscolean, 2014, p.112). The optimal financial structure reflects that composition of capitals, which allows economic entities to achieve the established objectives, in accordance with market requirements and to maximize market value. The financial base of an economic entity consists of its equity.

At the base of the management of the company’s equity is the management of the formation of its own financial resources (Stancu, 2022, p.56). For ensuring the efficiency of the administration of this process, the economic entity develops a financial policy aimed at attracting financial resources from various sources, in accordance with the needs of its development, from the next period.

2. Theoretical background

Over time, within the economy, the nature and importance of enterprises has been the object of study of numerous specialized works, and the changes and evolutions of the concepts related to the equity of an economic entity can be traced over time. The term *capital* comes from the Latin language, from *capita* (Stancu, *et al*, 2012, p.133). In ancient times, livestock owners would lend a number of cattle “heads”. The loan, at first, had to be repaid exactly in the borrowed amount, and later, with a surplus with an interest. The capital is therefore the good that multiplies the initial wealth many times more than any other known good or action. The first theoretical approaches regarding the content of capital appeared since antiquity, in the work of Aristotel (384-322 BC) in the form of the notion of wealth. Analytical spirit, Aristotle distinguished between the direct exchange between products or goods for goods (M-M), which existed before the appearance of money, and the mediated exchange of money. Aristotle’s logic regarding the prehistory of the economic theory of capital was the starting point for the classics of political economy and for K. Marx.

The term capital was introduced into the economic language since the XI-XII centuries. Initially, this term was assigned the meanings of: fund, stock of goods, clod for a business, income-generating money (interest). In the XIII-XIV centuries, the term capital begins to be used with the meaning of wealth, monetary assets, value, funds, self-valued value, patrimony. For the first time, Quesnay suggests the idea of dividing the capital into: initial advances (fixed capital) and annual advances (circulating capital), depending on how it is allocated (at the beginning of the agricultural activity or during the development of the agricultural activity). The modern meaning of the notion of capital was consecrated by economic theory at the end of the 18th century by the French physiocrat A.R.J. Turgot, (1727-1781) who, as early as 1770, wrote “capital no longer means only money, but more, participation in the production of values and profit”. The peak moment of classical economic liberalism was the works of Adam Smith and David Ricardo. Such simplistic approaches, at first sight, have their origins in economic scientific works published over time. Therefore, an elaborate analysis of the origin, division and circulation of capital is as interesting as the analysis of the nature and importance of economic entities in society.

From a theoretical point of view, reference publications, both by national and foreign authors, were used as the basis for the elaboration of this work, the annual financial statements and accounting reports being used as an informative basis.

3. Research methodology

During the research, the authors respected the specific rules of the research methodology, such as: reviewing the specialized literature, collecting, and processing conclusive data and information and synthesizing the theoretical aspects. Among the specific research methods, the authors focused on observation, statistical grouping, deductive research, comparison, and case study including the economic analysis of the main economic-financial indicators and finally, the interpretation of the obtained results. The theoretical research focused on the analysis and description of the current state of knowledge as a result of the documentation from a theoretical point of view, and the empirical research complemented the theoretical research with the translation into practice of information regarding the analysis of economic-financial indicators and the degree of financial use of resources within an economic entity. The entire research process was subject to rules regarding the rigor of the research, its objectivity and probity, in order to obtain valid and reproducible results.

4. Findings

4.1. The Role of Analysing the Financial-Patrimonial Structure of an Economic Entity

The elaboration of the financial and accounting statements of the economic entity, at the end of each financial year, are the basic source of the economist in the financial analysis. The analysis of the financial-patrimonial structure carried out for each individual year will present us, through the obtained indicators, the economic reality of the entity and its mode of operation during the analysed period.

The calculation of these indicators has the role of helping the business environment and enables investors to intervene by applying decisions where the entity registers structural rates with unprofitable indicators by remedying them. The financial indicators allow us, through the obtained results, to hold stocks of information about the economic performance of the entity, but also about its market ranking position in the field of activity (Răscolean *et al*, 2021, p.79).

Also, the analysis of the financial-patrimonial structure allows a comparison, between the basic entity and the association with other competitive entities that have the same field of activity, and which are assets on the Romanian market at the time of the comparison.

At the same time, in the analysis of the structure of assets and liabilities, the economic indicators can be calculated, the working capital, the working capital requirement and the net treasury can be determined, using the information that was detailed in the financial statements, by the responsible person within the entity/company, at the end of each calendar year. The role of preparing financial statements is, among other things, their transmission to third parties and to satisfy the need of all users interested in the financial status of the economic entity and its patrimony.

All analysis models of the financial-property structure are calculated in percentages, in days or in absolute values depending on the indicators required by the users interested in the functioning of the entities. The role of this analysis of the financial-patrimonial structure is to allow a wider knowledge of the entity's patrimonial situation and to achieve and exceed the estimated financial profitability in the medium and long term (Stancu *et al*, 2015, p.133).

4.2. The Analysis of the Financial and Patrimonial Structure at S.C. AS Construct S.R.L. Ilfov

The analysis of the financial-patrimonial structure based on the balance sheet aims to analyse the stage in which the economic entity is, the financial balance, the financial potential in the future, the realization of profit or loss, the total assets, the equity capital and the market competition. Having a great importance in the evaluation of the entity, is the net result of the exercise resulting from the analysed financial statements, for the fiscal period of the years under study 2019-2021 and especially the second part of the accounting balance sheet, where the evolution of equity from the analysed period can be observed.

From the annual financial statements, respectively the abbreviated balance sheet and the primary record documents that reflect the means and sources of financing, as a result of the analysis for the financial-property structure, it will be possible to know: the level of the investment made, the size of

the expenses and the degree of the capital use. From the analysis of the asset and liability structure ratios, the evolution of the economic entity's patrimony and the level of liquidity for the period 2019 – 2021, the following data, which are contained in table no.1, resulted.

Table no. 1. The Financial-Equity Capital Analysis Structured by Asset and Liability Elements at S.C.AS Construct SRL Ilfov

- lei -

Assets/Liabilities Element Name	Year 2019	Year 2020	Year 2021
Fixed Assets - Total, of which:	267.040	47.433	32.801
Intangible Assets	2.209	2.209	2.209
Tangible Assets	170.565	45.224	30592
Financial Assets	94.267	-	-
Current Assets - Total, of which:	1.615.560	1.559.833	1.367.574
Inventories	1.022.606	988.297	1.091.273
Claims	347.141	247.917	119.805
Available	245.813	323.619	156.496
Prepayments	-	217.643	-
Total Assets	1.882.500	1.607.266	1.400.375
Total Equity, of which:	1.365.738	1.025.990	939.369
Social Capital	440	440	440
Legal Reserves	88	88	88
Reported Result	1.067.667	981.775	823.232
Exercise Result	297.631	43.686	115.609
Profit Distribution	88	-	-
Total Debts, of which:	516.863	798.919	461.006
Debts < 1 year	468.181	757.463	205.836
Debts > 1 year	48.682	47.456	255.170
Revenue Recorded in Advance	-	-	-
Total Liabilities	1.882.601	1.824.909	1.400.375

Source: authors' processing

The following can be seen from the data presented in the table: the sales in 2020 increased, which caused a decrease in the outstanding debts; the stock is kept relatively constant, following the buyers' requirements more closely; the amount of 217,643 lei recorded in advance expenses in 2020 which represents the rent paid in advance for the commercial space.

4.3. The Analysis of the Indicators that Characterize the Equity Capital of S.C. AS Construct S.R.L. Ilfov

Using the information summarized in the annual financial statements of the analysed economic entity, a series of financial indicators can be calculated that allow, through the results provided, a pertinent analysis of the economic performance, and a ranking of it within the field of activity.

4.3.1. The Analysis of Equity Capital Utilization Indicators in Relation to Total Assets

$$K = \frac{\text{Equity Capital}}{\text{Assets Total}} \times 100$$

Table no. 2. The Equity Capital Utilization Ratio Relative to Assets

- lei -

Element name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Total Assets	1.882.500	1.607.266	1.400.375
K (coefficient)	72,55%	63,83%	67,085

Source: authors' processing

This indicator shows to what extent the economic entity uses its equity capital in relation to its assets, an improvement can be observed in 2020 and 2021 compared to 2019, in percentage of 8.72% in 2020 and 5.47% respectively in the year 2021.

4.3.2. The Global Financial Autonomy Ratio (R_{afg}) or Patrimonial Solvency

$$R_{afg} = \frac{\text{Equity Capital}}{\text{Liabilities Total}} \times 100$$

Table no. 3. The Global Financial Autonomy Ratio

- lei -

Denumire element	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Total Liabilities	1.882.601	1.824.909	1.400.375
R _{afg}	72,55%	56,22%	67,08%

Source: authors' processing

The analysis of this indicator shows that the share of equity capital in liabilities total decreased in 2020 and 2021 compared to 2019, by 16.33% and 5.47%, respectively, which indicates that the entity resorted to new loans, as no new ones were recommended loans.

4.3.3. The Term Financial Autonomy Ratio

$$R_{atf} = \frac{\text{Equity Capital}}{\text{medium and long term debt}} \times 100$$

Table no. 4. The Term Financial Autonomy Ratio

- lei -

Element name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Medium and Long Term Debts	48.682	47.456	255.170
R _{atf}	2805,43%	2161,98%	368,13%

Source: authors' processing

As a result of the profitable development of the activity, the own capital is sufficient for the full coverage of the debts of more than one year, the financial autonomy in the term presenting values much higher than the minimum threshold allowed throughout the analysed period. The negative variation of this indicator is due in 2020 and 2021, respectively, to the increase in the level of medium and long-term debt.

4.3.4. The Global Debt Ratio (R_{ig})

$$R_{ig} = \frac{\text{Total Debt}}{\text{Equity Capital}} \times 100$$

Table no. 5. The Global Debt Ratio

- lei -

Element Name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Total Debts	516.863	798.919	461.006
R _{ig}	37,84%	77,87%	49,08%

Source: authors' processing

The global indebtedness rate increases in 2020 and 2021, respectively, compared to 2019, as a result of debts to the state budget and the increase in the number of personnel. However, the value of this indicator does not exceed the 200% threshold, although the variation over time is negative.

4.3.5. The Term debt rate (R_{it})

$$R_{it} = \frac{\text{Medium and Long Term Debts}}{\text{Equity Capital}} \times 100$$

Table no. 6. The Term Debts Ratio

- lei -

Element Name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Medium and Long Term Debts	48.682	47.456	255.170
R _{ig}	3,56%	4,63%	27,16%

Source: authors' processing

Although there is a negative increase in the term debt ratio, from 3.56% in 2019, to 4.63% and 27.16%, respectively, the economic entity presents this indicator below the maximum allowed level of 100%.

4.3.6. The Financial Return (ROE)

$$ROE = \frac{\text{Net Profit}}{\text{Equity Capital}} \times 100$$

Table no. 7. The Financial Return (ROE)

- lei -

Element Name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Net Profit	- 69.026	27.392	63.026
ROE	- 5,05%	2,67%	6,71%

Source: authors' processing

This is one of the most important indicators for measuring the performance of an entity, it basically represents the contribution of associates to the financing of the business.

4.3.7. The Equity Capital to Operating Cash Flow Coverage Ratio (RCFNO)

$$RCFNO = \frac{\text{Operating Cash Flow}}{\text{Equity Capital}} \times 100$$

Table no. 8. The Equity Capital to Operating Cash Flow Coverage Ratio (RCFNO)

- lei -

Element Name	Year 2019	Year 2020	Year 2021
Equity Capital	1.365.738	1.025.990	939.369
Operating Cash Flow	59.491	- 32.195	64.360
RCFNO	4,35%	-3,13	6,85%

Source: authors' processing

The Equity Capital to Operating Cash Flow Coverage Ratio in 2020 decreases compared to 2019, reaching -3.13%, the value of operational payments exceeding the value of sales receipts and other additional receipts, but the situation recovers starting from 2021, when the RCFNO rate recorded positive values, namely a percentage of 6.85%.

4.3.8. The Analysis of the Entity's Patrimonial Financial Balance

The correlation between the working capital, the working capital requirement and the cash flow was analysed, the working capital representing the safety reserve of the economic entity. The patrimonial situation of the assets and liabilities at the end of the financial years are presented in table no. 9.

Table no. 9. The Financial Balance of the Entity

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Explications	31.12.2019	31.12.2020	31.12.2021
Fixed Assets	267.040	47.433	32.801
Current Assets	1.615.560	1.559.833	1.367.574
Total Assets	1.882.500	1.607.266	1.400.375
Equity Capital	1.365.738	1.025.990	939.369
Medium and Long Term Debts	48.682	47.456	255.170
Total Permanent Capital	1.414.420	1.659.008	1.273.068
Short Term Debts	468.181	757.463	205.836
Total Liabilities	1.882.601	1.824.909	1.400.375

Source: authors' processing

4.3.9. Working capital is the indicator that shows the long-term balance of the entity but allows a quick estimate of the entity's risk.

variant 1 FR = permanent capital - fixed assets

$$FR_{2019} = 1.414.420 - 267.040 = 1.147.380$$

$$FR_{2020} = 1.659.008 - 47.433 = 1.611.575$$

$$FR_{2021} = 1.273.068 - 32.801 = 1.240.267$$

The high value of the working capital indicates that the economic entity has sufficient liquidity for the full payment of debts in a relatively short term.

variant 2 FR = current assets - short-term liabilities

$$FR_{2019} = 1.615.560 - 461.181 = 1.154.379$$

$$FR_{2020} = 1.559.833 - 757.463 = 802.370$$

$$FR_{2021} = 1.367.574 - 205.836 = 1.161.738$$

As a result of the analysis of liquidity flows and payables for the period 2019 - 2021, a positive working capital resulted, which denotes the fact that the analysed economic entity presents financial balance, even having a liquidity surplus useful for covering long-term financing needs.

4.3.10. Working Capital Requirement

This is an indicator that expresses the need for financing of the analysed entity, being determined as follows:

NFR = current assets (inventories + receivables) - current liabilities (operating)

$$NFR_{2019} = (1.022.606 + 347.141) - 468.181 = 901.566$$

$$NFR_{2020} = (988.297 + 247.917) - 751.463 = 484.751$$

$$NFR_{2021} = (1.091.273 + 119.805) - 205.836 = 1.005.243$$

The year 2020 saw the lowest working capital requirement, noting that the debts increased with the year 2020, a fact that led the entity to take certain measures in the pace and quantity of supplies and merchandise stock.

4.4. Discussion

The financial-property activity of the entity under analysis, in the period 2019-2021, achieved positive financial results, managing to register a profit every year. During the analysis undertaken, the authors found that in the analysed period there was an accumulation of equity capital from as a result of the capital increase based on the profit of the management period.

Although at the beginning of the management period the return on capital registered a negative value as a result of the loss, ROE being -5.5%, the result of financial expenses and financial investments, the efficiency in the use of equity at the end of the analysed period increased, the profitability being 6.71% in 2021.

In addition to all these, through the financial-property analysis, it can be observed that the economic entity presents a financial stability as a result of the fact that the capital value provides approximately 90% of the asset value, which indicates that the company will not resort to additional loans.

5. Conclusions

Financial situations are those that help the administrator of an economic entity to prevent possible risks. The financial status represents one of the most important characteristics of the financial activity, it determines the degree of competitiveness of the economic entity and its potential in business, being the practical guarantor of the implementation of the common interests of all participants in financial relations. The entity's stable financial position is the result of good financial management, as well as the economic factors that determine the company's results. Equity capital, as a source of income and the main source of development, contributes to the achievement of the purpose of any business, namely profit and prosperity.

The financial stability analysis showed that the company has a stable financial position, as the capital value covers approximately 90% of the assets value and therefore the company will not resort to other loans. Evaluating the company's performance is a complex activity that cannot be guaranteed on the basis of a single indicator, especially in the case of the analysis of indicators related to the evolution of equity.

As a result of this study, the economic entity can increase its performance by: increasing the volume of production as a result of the full use of the production capacity; efficient use of labour and material resources, can lead to increased production volume; the reduction of financial expenses and the optimization of those related to the stocks held and the services procured; the systematic financial analysis of the factors that negatively affect the financial and economic performance of the entity, in particular the availability and liabilities in an inflationary environment; expanding the market by providing new services and selling new products; developing a set of indicators and analysing them based on a tested model; market analysis of that largest competitor; establishing a decision-making process based on performance indicators and their adaptation to market conditions.

From the perspective of finance, the economic entity aims to consolidate market activity and strategic development based on the study and analysis of profitability indicators.

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