

UTILIZATION OF MODERN METHODS IN MEASURING THE FINANCIAL PERFORMANCE OF THE COMPANY

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Abstract: Most entrepreneurs associate their financial performance with the achieved financial results. Each of them wants to be the best and the most successful in their industry and they need to achieve the best possible results. Therefore, it is necessary for them to monitor their financial performance. Except traditional methods of evaluating financial performance (financial analysis), they also focus on modern evaluation methods which consider not only accounting but also economic profit which also takes the alternative cost of capital.

Keywords: financial performance, measurement of financial performance, modern methods of financial performance measurement.

1 Introduction

In today's challenging competitive environment, one of the most important conditions for a company's long-term existence is its adequate financial performance. Measuring financial performance is an integral part of a company's financial management, which seeks to achieve a balance between financial performance and the company's financial structure. It is well known that deciding on the financial structure is one of the key and most complex tasks of a company's financial management. One of the main arguments in support of this statement is the fact that neither financial theory nor practice provide a universal guide, a generally acceptable recommendation for the composition of a company's financial resources. Each company is a unique organism with different characteristics. Its financial structure, taking into account the needs of the company and adequate capital requirements while ensuring the conditions of financial stability and sustainability, depends on a number of external and internal factors.

There are various indicators to measure a company's financial performance. In the past, the evaluation used mainly classic, traditional indicators of financial analysis, which are aimed at maximizing accounting profit. These indicators are compiled on the basis of accounting and tax regulations. These may include a certain safeguard, whether for the state or consumers. Criticism of traditional profitable quantities and financial indicators based on them can be summarized in the following points: "orientation on the past, neglect of economic effects after the end of the period, lack of capture of intangible assets and failure to take into account the cost of capital invested in the company," (Dluhošová, 2010, p. 18). Today's modern performance indicators capture economic profit and draw attention to the business owner and the maximum evaluation of his investment.

2 Financial performance of the company

Financial performance is the way in which a company can use assets from its core business and generate revenue. Through it, the company is able to influence other activities related to the financial management of the company. This term is also used as a general measure of the overall financial health of a company for a given period. "Financial performance is everything that takes place in the company and sooner or later it will be reflected in the financial results of the company, which are represented by the relevant financial indicators," (Lukáč et al., 2017, p. 12).

It is very important for the company, due to the constantly growing competition in the market, to continuously monitor its financial performance and know what its current position and financial situation was and where it was heading with its development. Measuring financial performance provides

information that helps business managers make better decisions. What is measured is easier to manage and control.

Measuring the financial performance of a company evaluates the course of the business process from two perspectives - in terms of the link between this process and the company's goals (efficiency) and in terms of the rationality of its course (effectiveness). It is a specific type of evaluation characterized by purpose orientation. They differ in relativity and subjectivity. Relativity requires that reality be compared with expected developments; subjectivity means that the measurement is influenced by the person who performs it. The measurement is partial if it is carried out during the business process.

Several authors comment on measuring the financial performance of companies. Teplická and Daubner characterize the measurement of financial performance "as a process of quantifying the effectiveness and efficiency of a particular action," (Teplická, Daubner, 2013, p. 7). Both of these authors also identified the basic features that characterize the process of measuring a company's financial performance. Basic features:

- Using a variety of measurements for company performance - financial, non-financial, internal, external, performance, results.
- The process is linked to the company's strategy, not isolated.
- It affects the environment of the company through various measures, which are implemented based on the results of performance measurement. Therefore, the process is part of the planning and controlling processes in the company.
- The process evaluates the impacts of business activities on the company's environment (internal and external).

"Measuring financial performance as a process has its rightful place in the company. Within its position, at the beginning is the vision, mission, philosophy and values that the company professes. When a company knows where it wants to go, what it wants to achieve, it can set a strategy. It also implies a long-term goal for the company, which should be achieved through the strategy. Setting goals is important for a company because it moves it forward and avoids the stagnation. The company's goals are achieved through business activities and processes that must be well planned in advance. Since the company needs to know whether and how the goals were met or not met, it is necessary to measure them (measuring financial performance). These results are the basis for comparing the plan with reality, and on the basis of this comparison, the company is able to determine the causes for the failure - why the given objectives were not achieved. Based on this, the company determines the strategy for the next period. It knows what to improve and what measures to take to improve the company's financial performance (financial performance management)," (Teplická, Daubner, 2013, p. 7).

3 Modern methods of measuring the financial performance of the company

Modern methods of measuring the financial performance of the company were created on the basis of criticism of previous traditional methods. Most of their indicators are based on accounting methods and procedures that do not always correspond to the economic view of the company's financial performance. In addition to accounting profit, modern methods also work with economic profit, the costs of which are made up not only of accounting costs but also of alternative costs, which are called opportunity costs.

The most frequently used and most popular indicators of measuring the financial performance of a company through modern methods:

- Return On Net Assets (RONA),

- Economic Value Added (EVA),
- Cash Return On Gross Assets (CROGA),
- Cash Flow Return On Investment (CFROI).

3.1 Return On Net Assets (RONA) indicator

RONA, a frequently used indicator of return on net assets in practice, is the first indicator of measuring the financial performance of a company through modern methods. This indicator of modern methods indicates how a company performs in comparison with other companies in the industry. It shows how well the company uses its resources and how it is able to make various decisions to ensure the viability of the company as a whole. It is an important measure of a company's profitability.

The indicator is calculated as the ratio of net profit after tax and net assets, ie the sum of fixed assets (non-current assets) and net working capital. Net working capital is a term that refers to current assets after deducting current liabilities. From the above it is possible to derive a formula in the form:

$$\text{RONA} = \text{net profit after tax} / (\text{fixed assets} + \text{net working capital})$$

This indicator belongs to the group of value indicators and is often used in practice. "It is based on a proportional analysis of the financial output and the resources spent on this output. The financial output is considered to be profit after tax and the volume of outputs is considered to be net assets, which are defined as the sum of fixed assets and working capital," (Kislingerová, 2010, p. 122).

Since the return on net assets (RONA) measures the change in the company's wealth (net income) relative to net assets, it is possible to compare the change in net assets with total net assets and obtain a rate of financial return.

This indicator is closely related to another indicator belonging to modern methods of measuring the financial performance of the company - EVA. If the value of the RONA indicator is greater than the value of the WACC (weighted average cost of capital), the value of the EVA indicator is positive. Conversely, if the value of the EVA indicator is negative, if the value of the RONA indicator is less than the WACC. The reason is that the EVA indicator equals $(\text{RONA} - \text{WACC}) * \text{invested capital}$.

3.2 Economic Value Added (EVA) indicator

EVA is the second and very important indicator. It was developed commercially in 1982 and gained recognition precisely for its innovative way of looking at the real profitability of the company. The basic principle of the EVA indicator is to evaluate the performance of companies on the basis of economic value, which managers and owners add to the business and return to owners. Unlike traditional methods of measuring financial performance, EVA focuses on the residual profitability of a company, which is adjusted for the direct cost of debt and also the indirect cost of equity. An enterprise is not truly profitable unless it makes a return on the capital invested in excess of the cost of capital opportunities.

Basic formula for calculating the EVA indicator:

$$\text{EVA} = \text{NOPAT} - \text{WACC} * \text{C}$$

where:

NOPAT = Net Operating Profit After Taxes

WACC = weighted average cost of capital in decimal (% * 1/100)

C = Capital (long-term invested capital)

Parameter C represents long-term invested capital. It is the sum of equity and interest-bearing borrowings. Alternatively, the value of C can be calculated as the sum of fixed assets and net working capital.

According to (Bartošová et al., 2018, pp. 112 - 113), the EVA indicator can be calculated in up to three ways. The first is the

calculation of the EVA entity indicator, which is calculated after adjusting the basic formula as follows:

$$\text{EVA1} = \text{EBIT} * (1-t) - \text{WACC} * \text{C}$$

where:

EBIT = earnings before interest and taxes

(1-t) = EBIT after tax

WACC = weighted average cost of capital in decimal (% * 1/100)

C = Capital (long-term invested capital)

WACC * C = weighted average cost of the enterprise to raise total capital

The second method of calculating the EVA indicator is as follows:

$$\text{EVA2} = \text{PVH} * (1-t) - \text{WACC} * \text{C}$$

where:

PVH = operating profit

WACC = weighted average cost of capital in decimal (% * 1/100)

C = Capital (long-term invested capital)

WACC * C = weighted average cost of the enterprise to raise total capital

Compared to the previous design of the EVA indicator, there has been a change in the PVH parameter, which characterizes the company's production strength. The EBIT indicator is replaced by the PVH indicator, the value of which can be obtained directly from the profit and loss statement.

The third and final method of calculating the EVA indicator shows the efficiency of the investments made on the basis of quantification of the amount by which the value of the company increased in the observed period. The calculation method is as follows:

$$\text{EVA3} = \text{VK} * (\text{ROE} - \text{NvK})$$

where:

VK = equity of the company

ROE = return on equity in decimal (% * 1/100)

NvK = cost of equity (opportunity cost of shareholders - market capitalization rate) in decimal (% * 1/100)

The simplest way to calculate the EVA is this third calculation, as it does not require the weighted average cost of capital. This means eliminating the amount of adjustments that each analyst perceives subjectively.

The EVA indicator also has its recommended values. If $\text{EVA} > 0$, the company is considered successful with a good financial situation. The middle gray zone occurs when $\text{EVA} = 0$, then the company was able to produce only the amount that was invested. And finally, the worst case scenario for the company is if $\text{EVA} < 0$, ie. that the value for owners/shareholders has decreased.

3.3 Cash Return On Gross Assets (CROGA) indicator

The indicator CROGA (cash return on gross assets) is another modern method of evaluating the financial performance of the company or. return on gross assets. The indicator works with the operating cash flow of the company (cash flow) and not with the profit like most indicators. The operating cash flow itself is created through the main business activity of the company and is expressed as the sum of profit and depreciation.

"The use of gross assets in the denominator of the GROGA indicator eliminates the distortion resulting from the use of book residual prices," (Zalai et al., 2010, p. 146).

This indicator can be calculated according to the formula:

$$\text{CROGA} = \text{OATCF} / \text{GA}$$

where:

OATCF = Operating After Tax Cash Flow

GA = Gross Assets

The result of the CROGA indicator is compared with the WACC indicator. If the result of the CROGA indicator is higher than the result of the WACC indicator, the company creates value for the owners.

3.4 Cash Flow Return On Investment (CFROI) indicator

The last of the mentioned indicators from the group of modern methods of measuring the financial performance of the company is the CFROI indicator - return on investment based on cash flows. It was created by the American company HOLT Value Associates and expresses an estimate of the real rate of appreciation of the company's gross investment base through cash flows.

The indicator expresses financial performance, similarly to the ROA (Return on Assets) indicator for the company as a whole, ie regardless of the financing structure. The conceptual difference between ROA and CFROI is that CFROI is based on cash flows and ROA is based on profit or loss. The rule is that the value of this indicator should be higher than zero.

A simplified form of the formula of this indicator according to (Zalai et al., 2008, p. 254) is in the form:

$$\text{CFROI} = \frac{\text{CF before tax + interest}}{\text{(fixed assets + net working capital)}}$$

Fixed assets specified in the formula are valued at historical (acquisition) prices. The CFROI indicator should be subject to the condition that the company should in the following years "achieve a constant volume of operating cash flow, in an amount that is identical to the cash flow in the period under review," (Vochozka, 2011, p. 32).

4 Conclusion

Only a company whose management can face changes in the business environment will gain long-term success and a stable position on the market. Therefore, continuous evaluation of the financial performance of companies becomes a key and irreplaceable tool of financial management of each company in order to constantly look for ways to improve it.

The approach to assessing the financial performance of a company has undergone a significant change in recent decades, which was mainly the transition from traditional methods to the preferred modern methods. The reporting capacity of traditional financial performance indicators, based on information from previous years, does not provide an objective view of the potential growth of a company's financial performance in the future. Therefore, in assessing the future success of the company, indicators are used that prioritize measuring the financial performance of the company in terms of increasing its value.

The topic of financial performance of a company has long been one of the most important problems addressed by theory and business practice.

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