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Financial Performance of the Business Entities

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Abstract:

this article describes the financial performance of the business entities and analyses the role of financial performance in the financial activity of the companies.

Key words: finance, assets, revenue, management, security.

Introduction: Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. The term is also used as a general measure of a firm's overall financial health over a given period. It should be stated that financial performance plays a key role in attracting external finance for further improvements in this company. The improvements in the information technology sector have been providing privileges to provide broad and accurate data about the companies in both global and local level.

Literature Review

Several scientific articles and books have been analyzed and studied to identify the importance of financial performance of the business entities. According to Wouters M., [1] analysts and investors use financial performance to compare similar firms across the same industry or to compare industries or sectors in aggregate. There are many stakeholders in a company, including trade creditors, bondholders, investors, employees, and management. Each group has its own interest in tracking the financial performance of a company. Handfield and others refer that [2] the financial performance identifies how well a company generates revenues and manages its assets, liabilities, and the financial interests of its stake- and stockholders.

Additionally, Lynch and Cross [3] stated that there are many ways to measure financial performance, but all measures should be taken in aggregate. Line items, such as revenue from operations, operating income, or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. When it comes to the acquiring the accurate data about the financial performance of the business entities it should be noted that in the USA, a key document in reporting corporate financial performance, one heavily relied on by research analysts, is Form 10-K [4]. The Securities and Exchange Commission (SEC) requires all public companies to file and publish this annual document. Its purpose is to provide stakeholders with accurate and reliable data and information that provide an overview of the company's financial health. Independent accountants audit the information in a 10-K, and company management signs it and other disclosure documents. As a result, the 10K represents the most comprehensive source of information on financial performance made available to investors annually.

Methodology of the research

The methodology includes historical analyzes, systematic analyzes, and graphic methods. Statistics have been made by the help of official statistics of the world.

Results

Studies have been conducted to deeply analyze the financial performance of the companies and the significance of keeping the records in financial statements of financial performance.

Researches have revealed that financial statements include main 3 financial statements: the balance sheet, the income statement, and the cash flow statement.

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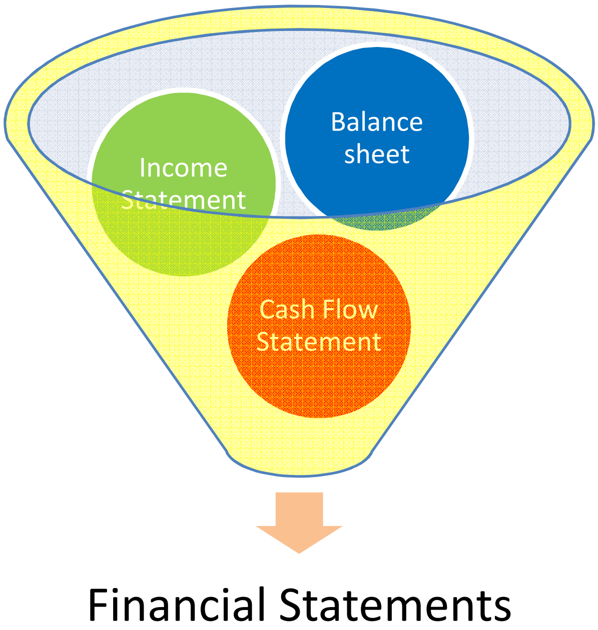

Figure 1

Types of Financial Statements[5]

Balance Sheet. The balance sheet is a snapshot of the finances of an organization as of a particular date. It provides an overview of how well the company manages its assets and liabilities. Analysts can find information about long-term vs. short-term debt on the balance sheet. They can also find information about what kind of assets the company owns and what percentage of assets are financed with liabilities vs. stockholders' equity.

Income Statement. The income statement provides a summary of operations for the entire year. The income statement starts with sales or revenues and ends with net income. Also referred to as the profit and loss statement, the income statement provides the gross profit margin, the cost of goods sold, operating profit margin, and net profit margin. It also provides an overview of the number of shares outstanding, as well as a comparison against the performance of the prior year.

Cash Flow Statement**.** The cash flow statement is a combination of both the income statement and the balance sheet. For some analysts, the cash flow statement is the most important financial statement because it provides reconciliation between net income and cash flow. This is where analysts see how much the company spent on stock repurchases, dividends, and capital expenditures. It also provides the source and uses of cash flow from operations, investing, and financing.[6]

When it comes to measuring Financial Performance through a financial performance analysis, specific financial formulas and ratios are calculated, which, when compared to historical and industry metrics, provides insight into a company's financial condition and performance. When calculating financial performance, there are seven critical ratios that are extensively used in the business world to assist and evaluate a company's overall performance.

Gross Profit Margin. The gross profit margin is a ratio that measures the remaining amount of revenue that is left after deducting the cost of sales. The ratio is useful because it indicates as a percentage the portion of each sales dollar that can be applied to cover a company's operating expenses.

Gross Profit Margin= ((Revenue – Cost of Sales)/Revenue)*100%

Working Capital. The working capital measurement is used to determine an organization's liquid net assets available to fund day-to-day operations. Determining liquidity in a business is important because it indicates whether a company owns resources that can quickly be converted to cash if needed.

Working Capital= Current Assets – Current Liabilities

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Current Ratio. The current ratio is a liquidity ratio that helps a business determine if it owns enough current assets to cover or pay for its current liabilities.

Current Ratio= Current Assets/Current Liabilities

Leverage. Leverage is an equity multiplier that is calculated by a business to illustrate how much debt is actually being used to buy assets. The leverage multiplier remains at one if all assets are financed by equity, but it begins to increase as more and more debt is used to purchase assets.

Leverage= Total Assets/Total Equity

Table 2 Measurements of the financial statements

№	Measurements of the financial statements	Formula
1	Gross Profit Margin	Gross Profit Margin= ((Revenue – Cost of Sales)/Revenue)*100%
2	Working Capital	Working Capital= Current Assets – Current Liabilities
3	Leverage	Current Ratio= Current Assets/Current Liabilities
4	Others	

Financial performance measures (FPMs) are the most commonly used measures of productivity and efficiency in companies, with less consideration for non-financial performance measures. FPMs are regarded as traditional measures that lead to sustainability of a firm, hence they need to be properly managed and controlled. Financial performance measures (FPMs) play a paramount role in the productivity and efficiency of small and medium enterprises (SMEs). Notwithstanding, financial measures alone cannot sustain the business without the aid of nonfinancial performance measures (Gunday et al. 2011: 665). Initially, performance measurement was used to identify profit and control cash flow in an organization, prior to the early 1900s, when William Durant, founder of General Motors, realized that profit was not the ultimate result of an accounting exercise but rather the outcome of a cost stream pool throughout the supply chain (Morgan 2004: 529).

Table 2

Evolution of performance measurement [7]

1494	"Performance measures" originates from invention of double entry by Luca Pacioli (Eccles 1991:131).
1850	Application of modern performance measures to identify profit and control cash flow (Morgan 2004:522).
1900	Wiliam Durrant realised performance from outcomes measures of cost stream pool throughout the SC (Eccles1991:131).
1951	CEO of *General Electric*, Ralph Cardinar organised a task team to identify key corporate measures, consisting of financial and non-financial measures (Meyer and Gupta, 1994, cited in Neely 1999:207).
1980s	Companies realised the decline in financial records due to unnoticed deterioration in quality and customer satisfaction and then began to focus on quality (Eccles 1991:134).
1990s	Customer satisfaction became the primary focus for many businesses (Eccles 1991:134). During the mid-1990s businesses were concerned about how performance measures could be developed and deployed (Neely 2005:1266)
2000s	BSC became the popular performance framework (Neely et at. 2004:2; Ittner and Lacker 2003:2).

Conclusion

In conclusion, it can be said that Financial performance is the achievement of the company's financial performance for a certain period covering the collection and allocation of finance measured by capital adequacy, liquidity, solvency, efficiency, leverage and profitability and it has a key role in the development of the business entities.

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