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FINANCIAL INDEPENDENCE OF SELECTED COMPANIESAGAINST SECTOR RESULTS

PRÓBA OKREŚLENIA SAMODZIELNOŚCI FINANSOWEJ WYBRANYCH PRZEDSIĘBIORSTW W ODNIESIENIU DO WYNIKÓW SEKTOROWYCH

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Streszczenie. Pojęcie samodzielności finansowej przedsiębiorstwa oznacza prowadzenie działalności gospodarczej w większości na podstawie własnych wygospodarowanych środków pieniężnych. Celem artykułu jest przedstawienie występowania bądź braku samodzielności finansowej wybranych przedsiębiorstw, przy uwzględnieniu określonych relacji finansowych. Na tej podstawie możliwe było wskazanie, w jakim stopniu przedsiębiorstwa były w stanie finansować swoją działalność z własnego kapitału i w jakim stopniu utrzymywały zdolność płatniczą. Do badań posłużyły wskaźniki finansowe, których obliczenie było uwarunkowane dostępnością danych liczbowych w odniesieniu do trzech płaszczyzn badań: z zastosowaniem danych liczbowych analizowanych przedsiębiorstw, danych GUS oraz opublikowanych wskaźników sektorowych. Na postawie badań stwierdzono, że przedsiębiorstwa, poza jednym wyjątkiem, nie były samodzielne finansowo. Ten wyjątek to przedsiębiorstwo, które w całym analizowanym okresie było jednoznacznie samodzielne finansowo. Podmiot ten jako jedyny wśród badanych charakteryzował się bezpieczeństwem finansowym, niskim stopniem utraty płynności finansowej i stabilnością finansową, co dla odbiorców zewnętrznych może stanowić podstawę podejmowanych decyzji inwestycyjnych.

Key words: financial independence, financial situation, financial indicators, payment capacity.
Słowa kluczowe: samodzielność finansowa, sytuacja finansowa, wskaźniki finansowe, zdolność płatnicza.

INTRODUCTION

A company's financial situation is a term used to describe its overall financial condition resulting from economic decisions taken over a specific period of time. It reflects relations between company assets, liabilities and equity. Analysis of these relations allows to evaluate a company's capital structure and its financial independence, which implies that the company self-finances its operations and growth out of its ownundistributed profits.

Most studies focus on assessment of financial risk factors, insolvency risk or even the risk of bankruptcy. Of course, this approach is reasonable since it enables business owners to take prompt decisions to minimize the risk of their own business failure. These decisions involve consideration of such options as loans and borrowings, financial instruments, cooperation with new partners, and various types of investment.

On the other hand, it is advisable to gauge a company's financial independence in terms ofself-financing. This kind of information provides an overall picture of a company's financial conditions, repayment of debts, lack of payment gridlocks or return on invested capital.

The purpose of this study is to assess financial independence of selected companies over a specificperiod of time, based on existing financial relations.

MATERIAL AND METHODS

The research presented is only part of empirical research conducted by the author. For the purposes of this study, the research was limited to companies listed on the Polish Stock Exchange in Warsaw (GPW), whose main business activity is production of food and clothing. The group of food producers included Indykpol S.A., Tarczyński S.A., Zakłady Mięsne Kania S.A. (Kania Meat Processing Plant), whereas the group of clothes manufacturers included Bytom S.A., Vistula Group S.A. and Monnari Trade S.A. Availability of annual financial reports for the years 2012–2014 was an important selection criterion.

The primary research data were supplemented by financial information on businesses required to keep balance sheets according to the Polish Classification of Activities [PKD], and retrieved from the website of the Polish Central Statistical Office, as well as by sectoral indicators developed by the Financial Analysis Commission of the Academic Council of the Polish Association of Accountants. Since the data were available up to 2014, the research period covers three years, from 2012 to 2014.

Empirical research was conducted with the use of quantitative methods, including methods of assessing corporate financial situation. Such selection of research methods was conditioned by the availability of quantitative data: the first source was data on stock exchange listed companies, the second – data collected by the Polish Central Statistical Office (GUS), and the third – sectoral indicators. The findings are presented in a descriptive, numerical and graphic form.

THE CONCEPT AND MEASUREMENT OF CORPORATE FINANCIAL INDEPENDENCE

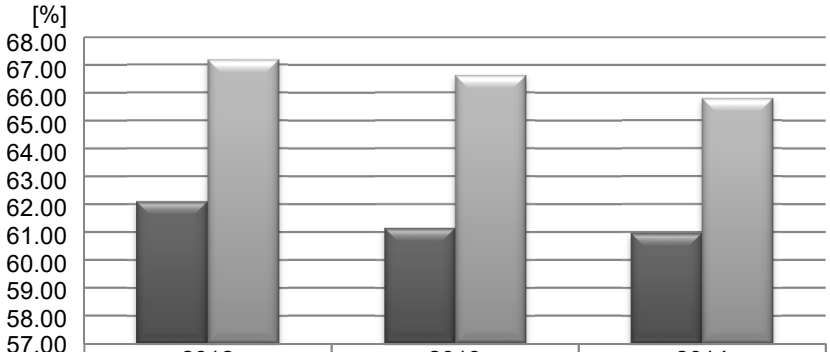
The concept of corporate financial independence is not as widely used as the concept of financial independence of local government units (LGU). In the latter case, it is used to evaluate their financial capacity in terms of revenue collection and expenditure capacity. It must be emphasized that the LGUs financial independence is not equivalent to financial self-sufficiency or autonomous finance management, since these areas are governed by legal provisions.

However, corporate financial independence is a different thing. Companies can take their own decisions regarding acquisition, collection, allocation and spending of their financial resources. Moreover, the financial policy pursued by a company can be based on the principle of financial self-sufficiency[1]. This principle is partly embodied in self-financing, which in economic practice is not a very common phenomenon, and is not always even possible.

[1] Self-sufficiency is a broad term and should be understood as a situation in which a firm performs all its processes and business activities with the use of its own financial, material and human resources, without relying on external support or investment. Financial self-sufficiency is thus a more narrow concept than the one discussed in the paper.

Start-ups, which are in a challenging financial situation, or dynamically growing companies are not able to finance their operations through profit reinvestment, writing down allowances, cash surplus or cash inflows from assets sold. This is why external funding is needed for most companies. This is illustrated in Fig.1 which presents the study companies' debt financing, that is financing through loans and trade credits.

As implied by Fig.1, the proportion of finance provided by debt is very large, the borrowed funds exceeding 60% share in total funds. Companies operating in the industrial processing sector are more prone to use this form of financing than other companies by ca.5 percentage points in each study year. However it must be underlined that the debt financing systematically decreased by ca. 1 percentage point per year.



	2012	2013	2014
Percentage of overall number of companiesusing loans and credits	62.09%	61.13%	60.95%
Percentage of companies using loans and credits in the industrial processing sector	67.17%	66.60%	65.78%

Fig. 1. Proportion of external funds (loans and trade credits) in companies' total funds in the 2012–2014 period
Source: own elaboration based on data retrieved from GUS (http://stat.gov.pl/obszary-tematyczne/podmioty-gospodarcze--wyniki-finansowe).

This situation encourages the author to focus on the capital structure of business and assess to what extent the study companies are able to self-finance their operations. The aim is to predict the risk of potential insolvency. Financial means of companies have the nature of internal financing, that is using profits as a source of capital for investment, and are also often considered the same as self-financing (Grzywacz 2008; Finanse 2013). As mentioned before, not all businesses have the opportunity to use internal financing, which is why the research focus is on company equity. Equity, as a secure source of financing operations, ensures financial stability and financial liquidity, and the use of equity does not expose the firm to insolvency risk (Duliniec 2007). It should be added that equity business financing, besides the many advantages, also has some weak sides. Among its advantages one should list the uncertain outcome, especially in deficit conditions, a relatively low return on equity, and the inability to benefit from financial leverage (Kaczmarek 2014). Since this study focuses on financial independence, only the positive sides of equity business financing were considered herein.

To assess financial independence of the study companies, some key indicators were considered, including debt ratio, cash ratio, return on equity ratio, two financial independence ratios. Moreover, the so-called “golden balance” was analyzed (relationships existing between equity and permanent capitals fully cover fixed assets). Table 1 presents the structure of indicators based on which calculations were made for the purposes of this study.

Table 1. Description of financial ratios

Ratios	Ratio formula
Debt ratio	total liabilities / assets [%]
Cash ratio	cash and cash equivalents / current liabilities
Return on equity ratio	net financial result / equity [%]
Equity ratio (financial independence 1st degree ratio)	equity / assets [%]
Total capital to assets ratio (financial independence 2nd degree ratio)	(shareholders’ equity + long-term debt) / assets [%]
Equity to fixed assets ratio (“golden balance rule”)	equity / fixed assets

Source: own elaboration based on: Bednarski and Waśniewski (1996), Analiza finansowa przedsiębiorstwa (2016).

The first ratio listed in Table 1, the debt ratio, measures financial leverage of a company and thus can be used to predict changes in its financial situation. It is commonly agreed in reference literature that for businesses, total liabilities should not exceed 2/3 of total assets. Debt ratio shows a company’s ability to finance its operations with its assets – a lower ratio implies a more stable business with the potential of longevity, and thus more financial independence since less borrowed funds are engaged in the business.

The second ratio, the cash ratio, measures a firm’s ability to pay off its current liabilities with only cash and cash equivalents. It also shows what is the minimum amount of cash and cash equivalents that a company should keep aside to be able to cover its current liabilities. It must be emphasized that this ratio determines a firm’s payment capacity and itsshort-term financial security.

Another ratio is return on equity (ROE) which shows to which extent equity financing allows a company to achieve net profits (or the equity to net loss). In other words, return of equity measures how efficiently a firm uses its equity to generate profits. However, one should be aware of how the ratio is calculated, meaning the numerator used in the formula. On the one hand, a low net profit may be a sign of a firm’s deteriorating financial health, and on the other hand, it may indicate the firm’s expansion through increased investment which implies increased costs that reduce its financial result. Therefore, using this ratio to assess profitability requires one to review recent financial reports.

Financial independence ratios 1st and 2nd degree differ from one another with regard to the long-term capital engaged in the company. The first one, the equity ratio shows ws how solvent and independent from external funding a company is, and it ensures that creditors will be paid back, regardless of the debt term. Moreover, the ratio measures the risks taken by potential creditors, and ensures the risk of liquidity loss is avoided. A higher ratio shows that the company is more sustainable, stable and solvent, and less risky to lend future loans. However, on the other hand, too high proportions of equity to assets deprives a firm of using leverage, and thus benefiting from a tax shield. The formula of the 2nd degree of financial independence ratio – the total capital to assets ratio – was extended to incorporate external capital in the numerical. This combination of shareholders’ equity and long-term borrowed capital constitute a company’s permanent capital which reduces the risk of capital outflow.

A significant difference between the two ratios means a relatively high proportion of outside capital, which in turn can suggest long-term investment conducive to the company's growth.

The last ratio is called the „golden balance rule", or else, equity to fixed assets ratio. It assumes that it is possible to determine to which extent capital tied up with a company for an indefinite period of time finances assets tied up for longer than a year. A relationship in which total equity is close to the value of fixed assets is sign of a firm's stability, financial health and low risk of financial liquidity loss.

The financial ratios described hereinabove have a high informative value and allow to gauge corporate financial independence.

COMPARISON OF FINANCIAL INDEPENDENCE OF SELECTED COMPANIES

Empirical research was conducted in three stages. As mentioned in the section: Research materials and methods, first a number of stock exchange listed companies, selected according to the criterion of quantitative data availability, were analyzed. They represent the two industries:

a) Food Production: Indykpol S.A., Tarczyński S.A., Zakłady Mięsne Kania S.A.;
b) Clothes Manufacturing: Bytom S.A., Vistula Group S.A. and Monnari Trade S.A.

For each company, financial ratios presented in Table 1 were calculated. Next, quantitative data obtained from the Polish Central Statistical Office (GUS) were correlated, and financial ratios calculated for companies that are required to keep balance sheets according to categories distinguished in the Polish Classification of Activities [PKD] – food production and clothes manufacturing. The GUS-based ratios are highlighted as GUS food and GUS clothes in the figures below. Last, sectoral indicators developed by the Financial Analysis Commission of the Academic Council of the Polish Association of Accountants were collected, which are highlighted as Food sector indicator and Clothes sector indicator in the figures below. Finally, the ratios computed for the study companies were compared with the GUS-based and sectoral indicators.

First, the debt ratio was analyzed, as presented in Fig. 2 below.

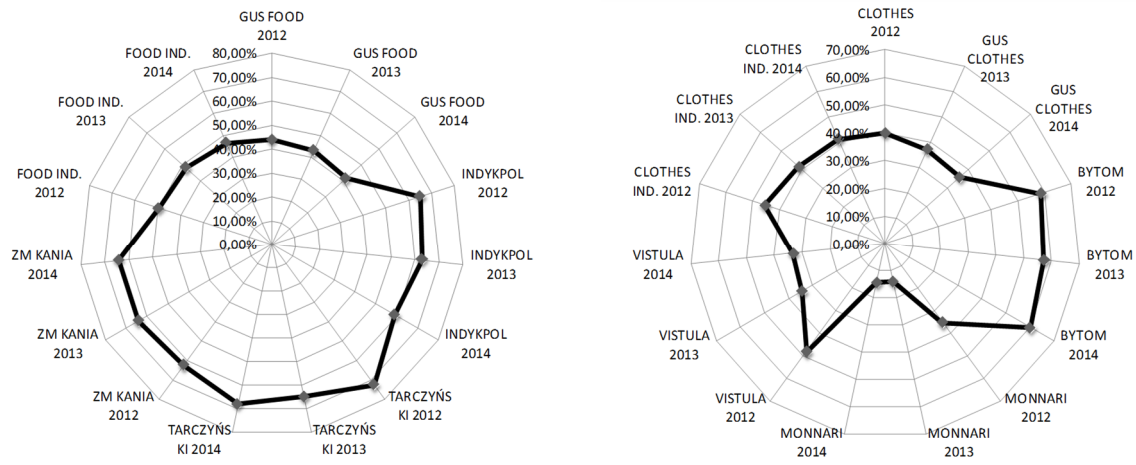


Fig. 2. Debt ratio by sectors and companies in the 2012–2014 period
Source: own elaboration based on Raporty roczne spółek… (http://www.parkiet.com/temat/21.html), Bilansowe wyniki podmiotów gospodarczych (http://stat.gov.pl/obszary-tematyczne/podmioty-gospodarcze), Wskaźniki sektorowe… (https://rachunkowosc.com.pl/wskazniki-i-stawki/wskazniki_sektorowe.html).

In the Food Production sector, according to sectoral data and data from GUS, the debt ratio did not exceed 50%. However, in companies the ratio was much above that – 60–70% on average. The highest debt ratio, of 72.5%, was recorded for Tarczynski in 2012. These results mean that companies have high leverage, that is they use loans to finance their working capital. This also implies they are faced with a rather high risk of losing their ability to meet their short-term obligations, which in long run can lead to loss of control over their solvency. In the Clothes Manufacturing sector the situation was different. Here, according to sectoral and GUS data, the debt ratio was about 36–45%. However, in companies the ratio took on different values, with the lowest ratio for Monnari, 14% in 2013–2014, and the highest, 60% for Bytom in 2014. A very low overall debt burden on Monnari tells of a debt limitation policy implemented by the company, which suggests its high financial independence and stability.

The next ratio analyzed is the cash ratio. It is a liquidity ratio that measures a company's ability to pay off its current liabilities with only cash and cash equivalents. Cash ratio of the study companies is presented in Fig. 3.

Fig. 3. Cash ratio by sectors and companies in the 2012–2014 period
Source: own elaboration based on sources used in Fig. 2.

The values of the cash ratio for the Food Production sector based on GUS data were ca. 0.5–1 percentage point lower than sectoral ratios. In the companies analyzed, these ratios were significantly lower, and only one company, Tarczynski, had a liquidity ratio of 0.19 in 2013. An alarming situation was observed in Kania Meat Processing Plant where in each study year the payment capacity was null, with a ratio of 0. Indykpol had a ratio of 0.01–0.05 over the entire study period. This means that its cash resources allowed the company to allocate between 1 to 5 groszy (Polish penny) to pay 1 zloty (100 pennies) of its current liabilities. Such a situation is very risky for a company since it may have difficulty funding its current debt. At the same time, companies with low cash coverage ratios are perceived as companies that give no guarantee of paying off the loans and have little financial independence, which of course discourages potential creditors.

The cash ratio for the Clothes Manufacturing sector was on average higher by 0.1 percentage point than in the Food Production sector, both according to GUS and sectoral data. However, also in this case the values differed, and the sectoral ratios were higher by 0.1 percentage point. Interestingly, the ratios of the study companies showed a big contrast – ratio of Bytom was almost identical to Indykpol, Vistula showed nearly optimal liquidity, although lower than sectoral and GUS indicators, whereas Monnari's cash ratio was nowhere near the comparative values. In the study period, Monnari liquidity ratio was in the range of 0.7 to almost 2. Such situation suggests the company's very good ability to meet its current obligations, and equals to no risk of insolvency. This can mean that the company pursues a very conservative cash management policy and does not engage its cash, but deposits cash in its bank accounts or saves for future investment. However, the value of this ratio is rather unusual, since high cash coverage ratio may also be the case of a company which has its receivables or other, such as external capital, paid at the end of the financial year.

Now we shall proceed to return on equity ratio presented in Fig. 4.

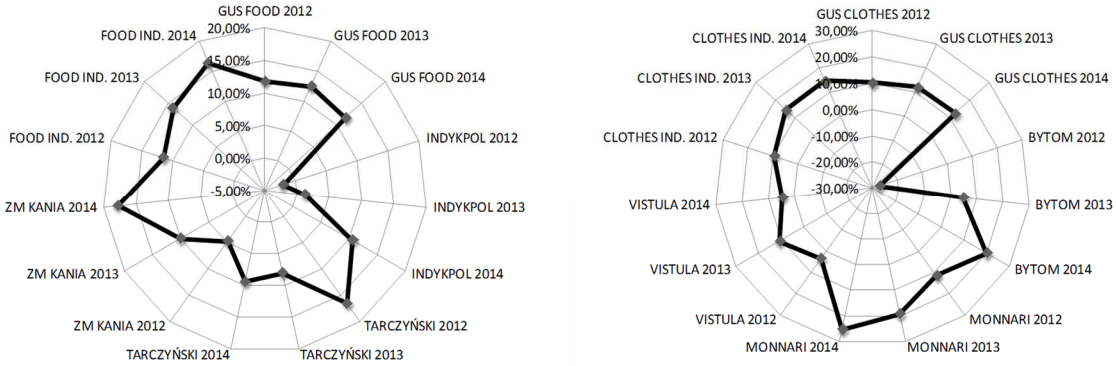


Fig. 4. Return on equity ratio by sectors and companies in the 2012–2014 period
Source: own elaboration based on sources used in Fig. 2.

The return on equity ratio for the Food Production sector was 12% on average according to GUS data, and 13–16% according to sectoral data. Return on equity ratio for selected companies was varied during the study period. Indykpol recorded a ratio of –2% in 2012, a slight improvement in profitability in the next year, and a 10% profitability in 2014. Also Kania Meat Processing Plant showed a rising profitability trend. In contrast, for Tarczynski the trend was rather volatile, although its net profit was stable in the study period (9–11 mln PLN), with consistently growing equity levels (in 2014, a 90% rise was recorded compared to 2012).

Return on equity ratios for the Clothes Manufacturing sector developed by GUS and sectoral institutions had similar value as the ones for the Food Production sector. However, a distinct spread in the ratios was observed in the study companies. For Bytom, negative profitability ratio of –27% in 2012 changed into positive ratio of 20% in 2014. The highest profitability was recorded by Monnari in 2014, with ROE ratio of 25.4%.

It is evident that the companies in both sectors displayed varying degrees of equity financing efficiency. Therefore, it is impossible to assess their financial independence. However, one may venture to conclude that companies which showed high profitability in the study period (Tarczynski, Kania Meat Processing Plant, Monnari and Bytom) were in good financial health thanks to the financial surplus generated.

We shall now move to 1st and 2nd degree financial independence ratios. As previously mentioned, they differ from one another with regard to the range of long-term capital engaged in the company, as it transpires from the formulae. Figures 5 and 6 present their values in a graphical form. It should be added that no sectoral indicators were available for the first ratio, that is equity to assets ratio, and the analysis had to be limited to data provided by GUS.

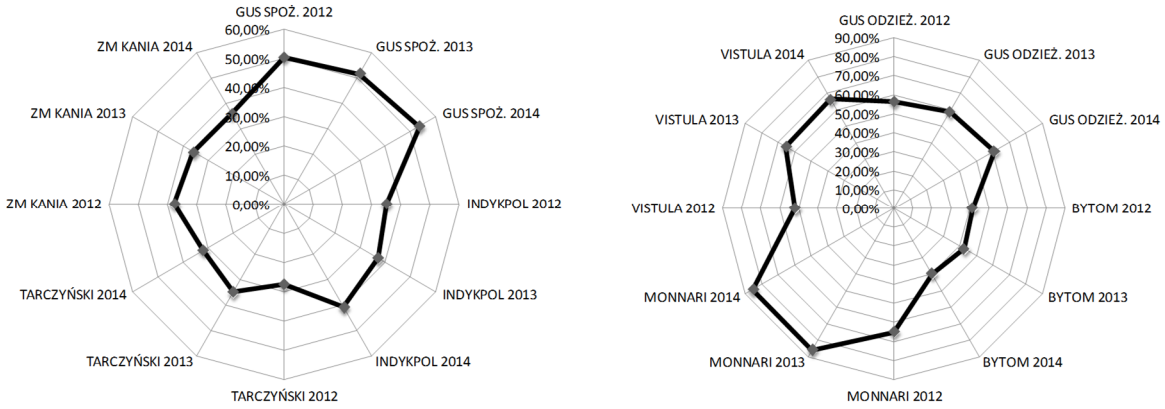


Fig. 5. Equity ratio by sectors and companies in the 2012–2014 period
Source: own elaboration based on sources used in Fig. 2.

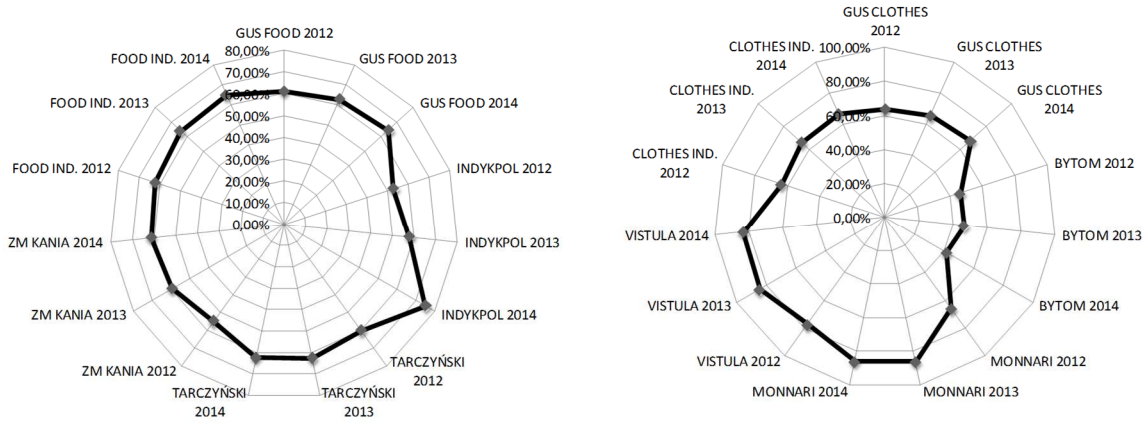


Fig. 6. Total capital to assets ratio by sectors and companies in the 2012–2014 period
Source: own elaboration based on sources used in Fig. 2.

According to GUS, the equity to assets ratio was around 50% for the Food Production sector, and slightly higher, around 60%, for the Clothes Manufacturing sector. None of the food production companies analyzed exceeded the mean value. This means that they are likely to be burdened with debts, since the proportion of equity in overall capital is relatively low. The lowest ratio was recorded in 2012 by Tarczynski (27.5%), and the highest in 2014 by Indykpol (40.8%). In companies operating in the Clothes Manufacturing sector, the situation was much better. In this case the companies relied more on equity financing than debt financing, which is sign of their stability and financial independence. The equity ratios were favourable, with 65–85% recorded in the study period by Monnari and 52–67% by Vistula.

Extending the previous ratio to include long-term external financing allowed to double check and reaffirm the financial independence of the companies under analysis. GUS-constructed ratios for the Food Production sector were almost identical as sectoral ratios, in the range of 61–65%. The ratio calculated for the study companies were on a similar level, with the only exception of Indykpol with a 75% ratio in 2014. However, significant disparity – of 15–25 percentage points – was observed between the equity ratio and the total capital to assets ratio. This means that there is a significant proportion of long-term capital involved in business operations, or in other words, the companies base their finance on external long--term financing.

As it comes to clothes manufacturers, a slight disparity between the two ratios was noted in Bytom (of 2–5 percentage points), much bigger disparity in Vistula (17–25 percentage points), whereas in case of Monnari the ratios had almost the same value (with less than one percentage point difference in 2012). Monnari did not use external long-term funding in 2013 and 2014, which confirms its very good financial health.

It must be added that the total capital to assets ratio calculated from data provided by GUS for the Clothes Manufacturing sector was at the same level as sectoral ratios, in the range of 63–67%, and it was close to the ratio for the Food Production sector.

The last ratio analyzed is the equity to fixed assets ratio, commonly called in Poland the "golden balance rule". Its values are graphically presented in Fig. 7.

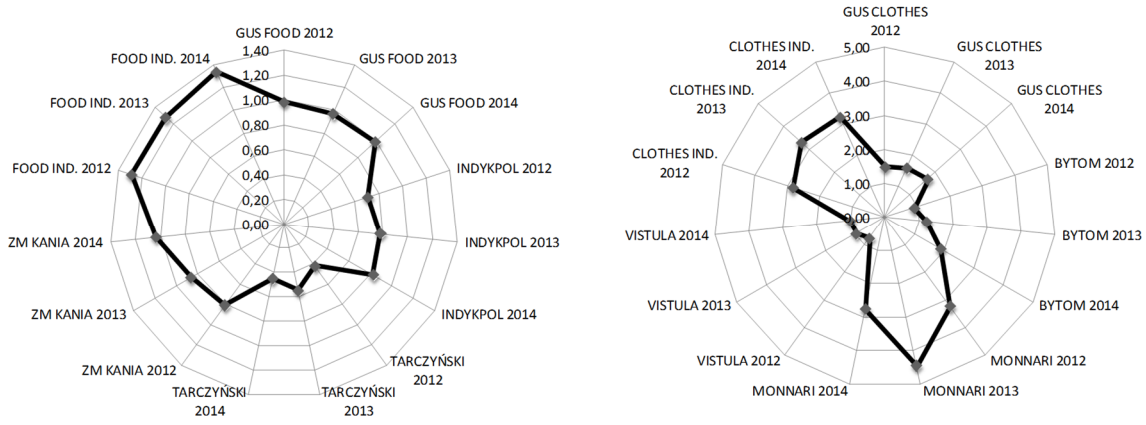


Fig. 7. Equity to fixed assets by sectors and companies in the 2012–2014 period
Source: own elaboration based on sources used in Fig. 2.

This a long-term solvency ratio based on fixed capital coverage. The ratio based on GUS data differed significantly from the ratio computed from sectoral data. In the Food Production sector, this difference is 0.3 on average, whereas in the Clothes Manufacturing sector it is 1.3–1.7. This means that the food production companies did not observe the "golden balance" rule. In other words, a ratio below 1 means that the shareholders' equity is less than the fixed assets and the companies use debts to finance a proportion of fixed assets. The most unfavourable situation was recorded in Tarczynski, in which only half of the company's fixed assets were financed by equity. Moreover, there was only one company – Kania Meat Processing Plant – in which the ratio was above 1 in 2014, which means that shareholders

equity is fully financing its fixed assets, and also financing part of its working capital. It can be thus concluded that in the food production companies a heightened risk of losing financial liquidity, temporary or permanent, occurred.

In contrast, the situation in clothes manufacturing companies was different. In most cases the „golden balance rule" was kept, which shows that they are more sustainable. In 2013 the ratio of Monnari was 4.45, which means that the company's equity was almost four and half times bigger than its fixed assets, and financed a large portion of its working capital. Moreover, comparison of this ratio with the equity and total capital to assets ratio confirms that the company has very low leverage.

In the last stage of research, the ratios presented above were used to determine financial independence of the study companies. For that purpose, the ratios of individual companies were juxtaposed with ratios based on data from GUS (sectoral data were not included due to their slightly higher values than GUS-based data). To ratios that exceeded mean values a „+" was assigned (a „–" only for the debt ratio), whereas „–" was assigned to the ratios that did not exceed mean values (and the opposite in case of the debt ratio). The results are presented in Tables 1 and 2.

Table 2. Financial independence of the study companies from the Food Production sector in the 2012–1014 period

Ratios	Indykpol			Tarczyński			ZM Kania		
	2012	2013	2014	2012	2013	2014	2012	2013	2014
1	2	3	4	5	6	7	8	9	10
Debt ratio	–	–	–	–	–	–	–	–	–
Cash ratio	–	–	–	–	–	–	–	–	–
Return on equity ratio	–	–	–	+	–	–	–	–	+
Equity ratio	–	–	–	–	–	–	–	–	–
Total capital to assets ratio	–	–	+	–	–	–	–	–	–
Equity to fixed assets ratio	–	–	–	–	–	–	–	–	+

Table 3. Financial independence of the study companies from the Clothes Manufacturing sector in the 2012–1014 period

Ratios	Bytom			Monnari			Vistula		
	2012	2013	2014	2012	2013	2014	2012	2013	2014
1	2	3	4	5	6	7	8	9	10
Debt ratio	–	–	–	+	+	+	–	+	+
Cash ratio	–	–	–	+	+	+	–	–	–
Return on equity ratio	–	–	+	+	+	+	–	–	–
Equity ratio	–	–	–	+	+	+	–	+	+
Total capital to assets ratio	–	–	–	+	+	+	+	+	+
Equity to fixed assets ratio	–	–	+	+	+	+	–	–	–

The above presented results indicate that the study companies have very low financial independence, or even that they actually lacked any financial independence whatsoever.The only exception here is Monnari, a clothes manufacturer, which can be considered fully independent and financially healthy as in every study year the ratios displayed positive values. It is asserted by the fact that the company showed high profitability in the entire study period, including equity profitability, and the earnings generated were allocated to pay off its debt. This was, among others, the reason why the contribution of borrowed funds was relatively low, which in consequence translated into high level of financial independence.

CONCLUSIONS

Due to limited access to financial information, the author used data from financial reports of selected, stock exchange listed companies. The research into financial independence of companies focused on 6 companies, 3 operating in the Food Production sector, and 3 in the Clothes Manufacturing sector.

The research findings allow to draw three basic conclusions:

1. The designed set of financial ratios was sufficient to meet the study's goal. This also means that although the application of a larger number of ratios might have yielded more detailed results, it would have been accompanied by unnecessary "information noise". Therefore, the designed set of ratios can be effectively used to measure corporate financial independence (in particular with regard to companies that are obligated to keep balance sheet reports as statements of financial position).
2. There were significant sectoral differences between the values of ratios of the study companies. Companies operating in the Clothes Manufacturing sector demonstrated more favourable ratios than the ones from the Food Production sector. The findings also let to conclude that companies engaged in the latter sector were more exposed to the risk of liquidity loss, showed high dependence on external funds and very low cash resources (CCE).
3. Only one clothes manufacturer company, Monnari, unanimously demonstrated good financial health and independence. In every study year, all ratios had higher values that the ratios based on data provided by GUS (Polish Central Statistical Office), with a much lower debt ratio. It may be thus concluded that Monnari, as the only company from the analyzed group, was financially stable and had no liquidity concerns.

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Summary. The concept of corporate financial independence assumes that a business relies predominantly on the company's own financial resources. The aim of the paper is to describe financial independence, or the lack thereof, of selected companies in the context of existing

financial relations. Such approach enables the researcher to gauge to what extent companies operated through equity financing, and how sustainable and solvent they were. Financial ratio analysis has been used for that purpose, subject to availability of statistical data obtained from the following three sources: the study companies, the Polish Central Statistical Office (GUS) and sectoral data base. The research findings indicate that companies do not have financial independence, with only one exception of a company that was financially autonomous throughout the entire study period. This is the only study company that enjoyed financial security and stability, was not at risk of financial liquidity loss, these being the key factors for potential investors.