

## SELF-FINANCING CAPACITY AND TAXATION INFLUENCE ON FIRM PROFITABILITY

Daniela SIMTION

Lucian Blaga University, Faculty for Agricultural Sciences, Food Industry and Environmental Protection, 7-9, Dr. Ion Rațiu, Sibiu, Romania, Mobile: +40721435221, Email: simtiondaniela@yahoo.com

*Corresponding author:* simtiondaniela@yahoo.com

### *Abstract*

*The paper deals with the influence of taxes on the company's profitability and self-financing capacity, presenting a case study. Taxes are being defined as sampling of a part of the income or wealth of a person. Based on the data collected from the Balance Sheet and Profit and Loss Account, the self-financing capacity of the firm was determined by two methods: the deductive method and the additional method. The self-financing capacity of SC ALFA CONSTRUCT S.R.L. registered an increasing trend in the analyzed period. Thus, in 2015, it reached Lei 1,105,443, being by 33.76 times higher than in 2013. As a conclusion, considering the influence of taxation on certain economic and financial performances we get to the following reality: taxation can be a determining factor in decision-making at enterprise level.*

*Key words:* expenses, profitability, revenues, self-financing capacity, taxes

### INTRODUCTION

The purpose of a business is obtaining results; based on these the people who invest in its capital will be paid.

These results should not be achieved at any cost because the entity with its activity which is insufficiently controlled and not adapted fully to the surrounding natural realities threatens the ecological balance [4].

The influence of taxation on company business results, determines decisions regarding the economical and financial policies of the company.

Self-financing capacity (CAF) expressed in monetary terms represents a firm's ability to ensure its development through own financial means.

This indicator calculated based on the results account expresses the difference between the company's collectible revenues and its payable expenses.

What must be emphasized is that the indicator for self-financing capacity can not highlight the effective returns and payments with the same accuracy as evidenced by the treasury. [2]

This is due to the fact that the determination

of the self-financing capacity is based on the assumption that revenues taken into count as collected revenues will be paid 100% and also payable expenses will be entirely performed.

Making traditional and environmentally friendly products is an important way to achieve self-financing of various areas where farming plays an important role in preserving natural and cultural heritage. [6]

A traditional product maintains the cultural heritage of the rural area and helps preserve cultural identity by preserving local traditions and customs: local holidays and festivals in which the local costumes, customs and products are promoted. [7]

The interim management balances represent value indicators which are determined based on the data contained in the income statement. These show us information about the company's profitability on different levels.

Specific to the interim management balances is their determination in cascade; a certain indicator is calculated based on a previously calculated indicator.

In this context, this paper aimed to show a case study regarding self-financing capacity and taxation influence on firm profitability

## MATERIALS AND METHODS

The case study is based on the interim management balances in the Anglo-Saxon way for three consecutive years for S.C. ALFA CONSTRUCT SRL.

the self-financing capacity was determined by two methods: the deductive method and the additional method.

The data were used to determine the self-financing capacity **through the deductive method** is based on the relationship:

CAF=collected revenues - payable expenses

This formula was detailed as:

CAF = EBE + other exploitation revenues - other exploitation expenses + financial revenues (excluding revenues from commissions) - financial expenses (except financial expenses with amortization and provisions) + extraordinary revenues (excluding exceptional revenues from the sale of assets, share parts of subsidies for investments transferred to revenues and for exceptional provisions) - extraordinary expenses (excluding the net accounting value of the transferred assets and the exceptional expenses with amortization and provisions.) – profit tax.

The formula for calculating the self-financing capacity through **the additional method** is:

CAF = year result (net result) + depreciation expenses + provision expenses (from exploitation, financial and extraordinary) - revenues from provisions (from exploitation, financial and extraordinary) + the net accounting value of the disposed assets - exceptional revenues from the sale of assets - the share of subsidies for investments transferred to revenues

## RESULTS AND DISCUSSIONS

**The deductive method** of determining the self-financing capacity takes into account all receipts and payments generated by the company's revenues and expenses, less the extraordinary ones coming from the disposal of the company's assets or from grants received for investments.

The argument for eliminating these elements is the fact that in order to properly and

competitive analyze a company's position in terms of self-financing we needed to make abstraction of those incomes or expenses which may have an adverse effect on determining the indicator.

These elements are taken into account when determining the financing picture of the company, their increase or decrease (depending on the concrete situation of each company) influences the resources available at company's level.

Thus, if in a given financial year the self-financing capacity of a firm would, for example, equal to 0, the incomes from the assets sale would be 100 and the net accounting value of the transferred assets would be 50, might create a false impression that the company is capable of self-financing, while this available surplus would be only the result of performing an operation which has very low chances of repeatability in the future.

There are also opinions that neither the other extraordinary revenue and expenses items should not be included in calculating the self-financing capacity with the deductive method, because they by having an exceptional character, do not represent elements that lead to an outcome that can be a benchmark for predicting the self-financing capacity [2].

In this study CAF was determined, firstly, using the deductive method.

In this case, CAF was determined using the formula: EBE + other exploitation revenues - other exploitation expenses + financial revenues (excluding revenues from commissions) - financial expenses (except financial expenses with amortization and provisions) + extraordinary revenues (excluding exceptional revenues from the sale of assets, share parts of subsidies for investments transferred to revenues and for exceptional provisions) - extraordinary expenses (excluding the net accounting value of the transferred assets and the exceptional expenses with amortization and provisions.) – profit tax.

EBE represents the collected revenues from exploitation- - payable expenses from exploitation.

The primary data collected from the Balance

sheet and Profit and Loss Account of S.C. ALFA CONSTRUCT SRL, concluded at the end of the years 2013, 2014 and 2015 are presented in Table 1.

The company turnover increased by 81 % from Lei 1,293,343 in 2013 to Lei 2,348,213 reflecting a positive trend.

The total revenues also increased by 81 % from Lei 1,298,466 in 2013 to Lei 2,352,034 in 2015.

Table 1. The primary data taken from the Balance sheet and Profit and Loss Account of S.C. ALFA CONSTRUCT SRL, 2013-2015

	2013	2014	2015
Revenues from executed works and done services		18,494,732	2,348,213
Works and services in progress		-26,497	
<b>Turnover - (adjusted with #711)</b>	<b>1,293,343</b>	<b>18,468,235</b>	<b>2,348,213</b>
Other operational revenues	5,123	143,022	3,821
<b>Total revenues</b>	<b>1,298,466</b>	<b>18,611,256</b>	<b>2,352,034</b>
Raw materials and supply expenses	448,878	11,452,162	790,155
Utilities expenses	0	0	
Rent expenses	43,202	208,968	23,036
Wage expenses and taxes	667,759	4,236,539	410,246
Other operational expenses	105,925	763,664	22,783
<b>Total expenses</b>	<b>1,265,765</b>	<b>16,661,334</b>	<b>1,246,221</b>
<b>EBITDA (Earning Before Interest, Taxes, Depreciation &amp; A mortization)</b>	<b>32,701</b>	<b>1,949,923</b>	<b>1,105,814</b>
Amortization	3,949	22,147	2,728
<b>EBIT (Earning Before Interests and Taxes)</b>	<b>28,752</b>	<b>1,927,776</b>	<b>1,103,086</b>
Financial revenues	42	39,331	1,153
Financial expenses	0	11,253	1,524
<b>EBT (Earning Before Taxes)</b>	<b>28,795</b>	<b>1,955,855</b>	<b>1,102,715</b>
Tax profit	0	330,258	0
<b>Profit/(loss) net</b>	<b>28,795</b>	<b>1,625,597</b>	<b>1,102,715</b>

Source: Balance sheet and Profit and Loss Account of S.C. ALFA CONSTRUCT SRL, 2013-2015

Total expenses declined by 1.55 % from Lei 1,265,765 in 2013 to Lei 1,246,221 in 2015.

As a result, EBT ( Earning before taxes) accounted for Lei 1,102,715 in 2015, being by 38.29 times higher than in 2013.

Net profit was equal to EBT as shown in Table 1.

The results obtained using the deductive method regarding the self-financing capacity at S.C. ALFA CONSTRUCT SRL. are presented in Table 2.

Table 2. Self financing capacity determined using the deductive method, S.C. ALFA CONSTRUCT SRL, 2013-2015

		2013	2014	2015
<b>EBE</b>		<b>32,701</b>	<b>1,949,923</b>	<b>1,105,814</b>
<b>Fin. revenues</b>	+	42	39,331	1,153
<b>Fin. expenses</b>	-	0	11,253	1,524
<b>Tax profit</b>	-	0	330,258	0
<b>CAF</b>		<b>32,743</b>	<b>1,647,743</b>	<b>1,105,443</b>

Source: Own calculations.

One can see that the self-financing capacity of the company registered an increasing trend in the analyzed period. Thus, in 2015, it reached Lei 1,105,443, being by 33.76 times higher than in 2013.

**The additional method** used in calculating the self-financing capacity has the net profit as a starting point, following that from this the calculated revenues will be deducted and the calculated costs will be added.

Decreasing the calculated revenues and adding the calculated costs is being done because the calculated revenues do not generate actual revenues for the company, and the calculated costs are not expenses involving cash flow payments.

Also from the net profit the extraordinary revenues from the disposal of assets or investment subsidies are being deducted, even if they generate cash incomes, which are not revenues, but are found constantly in the company's activity.

Also to the net profit the expenses representing the net accounting value of the transferred assets are being added, because even these as well as the revenues mentioned above, can not be found consistently in the financial activity of the enterprise, they can produce distortion in the analysis and forecast based on the self-financing capacity.

The results regarding the self-financing

capacity of the company in the study, determined using the additional method, are presented in Table 3.

Table 3. Self-financing capacity determined using the additional method, S.C. ALFA CONSTRUCT SRL, 2013-2015

		2013	2014	2015
Net profit/ (loss)		28,795	1,625,597	1,102,715
Depreciation	+	3,948	22,146	2,728
CAF		32,743	1,647,743	1,105,443

Source: Own calculations

The self-financing capacity is used for self-financing the company, as well as to pay dividends, the participation of the manager to the profit (manager share) and the participation of the employees to the profit. Self-financing represents a real interest to the company; it represents that part of the self-financing capacity which will be used to finance the business activity.

Its calculation formula is:

Self-financing = CAF - dividends - manager share - employee participation to profits

As seen in the calculating formula for self-financing, its level is influenced by the self-financing capacity of the company (therefore a result of it), but a major importance in determining its size has the policy for distributing the net profit. Thus, the self-financing size is indirect proportional to the size of the share distribution of dividends and share participation of employees and manager to the profit.

Taxation affects the company's profitability. Profitability analysis [2] is based on the profit and loss account (income statement). The income statement shows us how it reached a certain patrimonial final state; which were the income and expenditure streams [3]. Structuring revenues and expenses in the income statement is based on the delimitation of activities performed by the company in the exploitation activity, financial and extraordinary activity. Thus, we find in its structure revenues and expenses from exploitation, financial revenues and expenses, extraordinary revenues and expenses.

Analysis based on the income statement is made through intermediate management

balances. Along with the analysis of intermediate management balances, it calls also for the analysis of the self-financing capacity, as well as the analysis of the profitability benchmark.

Regarding heritage accounting, it describes interactions between man and environment both in monetary terms, but also in specific physical terms. [1]

The analysis of intermediate management balances according to the continental model is not the only way to analyze the results account, worldwide other approaches are also known, practiced mainly by Anglo-Saxon countries (England, USA, Canada etc.):

- Functional analysis of the income statement
- highlights the results according to the functions of the company: production, trade, research and development, treasury;
- Analysis through direct product costs involves establishing product costs directly related to the manufacture of a product, afterwards, based on distribution keys, indirect costs will be distributed;
- Analysis through variable costs related to the turnover - is an analysis that starts from dividing expenses into variable ones depending on the turnover and fixed expenses. Taxation intervenes for the first time in determining intermediate management balances when calculating gross exploitation surplus, as tax spending, taxes and similar duties and taxes intervening on wages (included in staff costs). Within these tax expenses there are also included: tax expenses related to the wages, costs with taxes on buildings, land tax and other local taxes, value added tax that goes to expenses and other taxes. Except tax expense related to salaries, taxes owed by the enterprise level is generally fixed for a certain scale of production activity, with no possibilities fiscal management in the interest of the company.

If we further analyze the way the results achieved by the company are being determined we see that a major importance has the size of the profit tax. In this case a series of analysis can be made regarding how to establish a fiscal strategy so that, based on the possibilities of applying the tax legislation, its impact level on firm

performance will be as low as possible. Thus, in determining the size of the profit tax payment a major importance has chosen the tax amortization, the possibility to deduct expenses in order to determine taxable profit and, at least in the present, the option for micro enterprises' income tax, if the entity may fall into this category.

We believe that taxation should also take into account the quality of the income, because man can suffer directly from pollution for e.g. the action of smog produced by the industry or indirect for e.g. the toxic action of oil spilled in the oceans over fish. [5]

## CONCLUSIONS

Accounting depreciation is acting on the profitability of the company, in the sense of diminishing the result of exploitation and indirectly decreasing the net value income and fiscal depreciation, by decreasing the profit tax payment. Analyzing the impact of depreciation on the self-financing capacity, only fiscal depreciation has any influence, because it lowers the profit tax payment. Accounting depreciation has no influence on the self-financing capacity, because if we start from the deductive method we do not take into account the amortization, and if we start from the additional method, even if at the net result we add the accounting depreciation, it was initially deducted from the gross exploitation surplus, and therefore the net result was diminished by its value.

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