THE ROLE AND THE LIMITS OF THE FINANCIAL AND ECONOMIC ANALYSIS IN MODERN ECONOMY

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One of Romania’s priorities for the fulfillment of the objectives generated by its accession to the European Union is to improve its business environment. As part of this objective we have presented the essential role of the economic and financial analysis that provides the necessary information for decision-making process. For the purpose of making an objective analysis, at the end of the paper we have also presented some of the limits of this resourceful and available instrument.

Keywords: the economic and financial analysis

The term analysis, as explained in the Romanian Language Dictionary, comes from French and has a double meaning. First, the verb ‘to analyze’ means “to investigate a whole, a phenomenon, etc., by examining each element...”. Second, the noun ‘analysis’ is “a scientific method of research based on the systematic study of each element; the thorough examination of a problem.”

Generally, analysis is a scientific method for the study of the phenomena and processes that are developed within society and nature. The analytical study involves the deconstruction of the phenomenon or of the process in its components, the identification of the coordination and subordination correlations between them, as well as of the situations that govern, maintain or cancel their presence.

By generalizing conclusions, analysis completes itself with synthesis which is a scientific method for the study of phenomena and which is based on the transfer from particular to general, from simple to complex for the purpose of achieving generalization.

The financial and economic analysis – concept and necessity

Romanian economy is deeply marked by centralism and the obvious domination of engineer based leadership, it hardly manages in the area of a strong atom-like market where the technique of selling products related to its complexity takes precedent over their production.

The change of the ownership form for the productive assets of Romania solves only partially the problems that were inevitably inherited on the level of production relations. In this respect, on the macroeconomic and especially on the microeconomic level it is necessary to stimulate the efficient activities that mainly use the technical and the economic experience accumulated on the national level.

The transfer from the centralized to the competition economy results into important changes within companies’ financial and accounting level.

The financial and accounting activity should be organized so as to offer the main shareholders and decision-makers objective and true information concerning the market value of the company, its position on the market as well as the respective business vulnerability within different markets contexts.

For the purpose of interpreting the tendencies and the relations in a consistent and orderly manner, analytical instruments are applied on financial data.

The use of external specialized collaborators for the economic and financial activity cannot solve all the problems occurring on the level of the enterprise, the activity of these external collaborators being extensively oriented towards standard analyses and solutions which describe the economic activity from exterior without detecting inner aspects that particularize the ways...
of the unique personality of the enterprise related to the new and sometimes contradictory economic phenomena of an economic and social system that is permanently changing.

For the initial stages of a business, it is profitable to resort to the services of a specialized consulting company which can guide the company to economic performance, yet it is preferable that from the moment of setting up the company, the economic and financial analysis to become an independent activity in the organizational structure of the company.

The internal analysis, as a permanent activity within the financial and accounting department, is vital for developing an efficient economic activity, no matter it is productive, commercial or service oriented.

We consider that the purpose of the economic and financial analysis is to know the essence of the phenomena and processes that are developed in the microeconomic area for the purpose of discovering the rules that govern the stimulation of the companies business portfolio.

To conclude, the economic and financial analysis, by its methods and procedures, represents an important instrument for companies’ management as it offers practical solutions to prevent and remove destructive factors and thus creates a beneficial environment for an unrestricted development of positive factors.

**Objectives of companies’ economic and financial analysis**

According to international accounting norms and in a relation separate from the financial situations, the financial analysis describes and explains the main characteristics of the financial performance and position of the enterprise, as well as the main uncertainties that are faced by it.

Such a relation may include an analysis of the major factors and influences that determine performance, as well as the reaction of the enterprise to the respective changes and their effect. The investment policy as well as that of the dividends is also of a major interest for the purpose of maintaining and improving these performances.

At the same time, the financial analysis should present the financing sources of the enterprise, the policy of risk indebted and management as well as the strong points and the resources of the enterprise whose value is not found in the balance sheet.

The economic analysis presents the behavior of the phenomena and processes that are developed in the economic environment by using investigation methods that are general or specific to it.

A central objective of the analysis is the increase of efficiency for the entire activity of the company. This objective is reached by the post fact, present and predictable knowledge of the evolution of the company’s cyber system, of its internal resources, as well as of the causes that determine their apparition and amplification.

In this respect, the analysis of the economic situation reveals the extent to which the resources are used extensively and intensively in the process of factors’ technical and economic combination and substitution.

We consider that the analysis of the financial situation reveals the unexploited resources of profitability, inflation, liquidity, solvability, the stock exchange situation of the company and the evaluation of the companies’ bankruptcy.

According to the theoretical considerations of the concept we consider that, apart from the central objective, the economic analysis has to follow other aims such as: the maximization of the market value of company’s shares; the assurance of the financial stability; the decrease of the company’s vulnerability and the prevention of the company’s risk of bankruptcy.

Within the market economy a company is subject to market laws, evolving according to its financial stability, to the position of the company on the market as well as according to the quotations of the company’s shares on exchange. That is why the maximization of the company’s shares value on
the market becomes an objective necessity imposed by the company’s development.

The development under optimal conditions of the company’s activity results into its evolution on the financial safe corridors that prevent the company’s financial imbalances. That is why it is necessary to impose a permanent monitoring of the company’s evolution and any deviation from the safe financial directions is to be reported to the company’s financial managers.

The company is permanently subjected to the negative effects of inflation, competition, macroeconomic instability or to world economic recession. The vulnerability degree shows the resistance of the company to the hostile economic and social environment and, on the other hand, refers to the company’s capacity to recover by itself.

The bankruptcy risk represents a permanent threat to any economic agent, that is why it is necessary to monitor this risk permanently with the help of certain banking, patrimonial, statistical, managerial methods, etc.

Moreover, we mention that in an economy where the situation of cash flow is considered as the most important financial reporting (we have mentioned the American economy), the financial analysis responds to other requests, respectively:

- it provides the necessary data for predicting gains and cash flows,
- it gives the necessary information for the assessment of the company’s capacity to get the necessary money for developing its activity,
- it provides the necessary means for identifying the management quality.

The external users of the financial reports are interested in the invested or borrowed capital profitability and by its comparison to the estimated profitability which is to compensate the assumed risk. At the same time they are interested in the business value for the purpose of mergers, sales, privatizations, but also by the shares value for informing the owners. The external users of the financial situations are interested in appreciating the financial risk, the bankruptcy risk of the unit and the guarantees that can be offered for informing the creditors for a possible analysis of the unit’s financial recovery and restructuring. Not less important, these users of the financial information want to identify the strong and weak points of the business management for estimating the business value and its risk.

The internal users, by concentrating on a properly management of the business, use the financial analysis to establish the financial and commercial policy of the unit. At the same time, with the help of the financial analysis, the employees and the unions can appreciate the financial situation and the possibilities for increasing wages.

**The limits of the financial and economic analysis**

According to some authors, the economic and financial analysis should allow the decision-makers and the social partners to appreciate the “health” state of the enterprise according to well-established criteria: the size of the guarantees offered to the third parties, the capacity to produce benefits, the capacity for self-financing and development etc.

Given this context, the objectives of the economic and financial analysis become: the assessment of the previous results as an indicator for the future performance, the evaluation of the future potential and of its inherent risks and finally the choice of the financial analysis criteria. Most developed countries (the USA for example) frequently use the following criteria of financial analysis: (i) guiding indicators; (ii) the previous results of the company; (iii) branch indicators.

The guiding indicators, though established as a rule by the specialized institutions or agencies, cannot guarantee that the values selected to serve as a base for comparison for a certain enterprise, represent the best choice, a reason for which it is recommended to use these indicators with cautious.

The comparison of the financial indicators of the same enterprise for a certain period of time does not always represent the best choice. The past may not be a good element for comparison if the
previous accomplishments are insufficient as compared to the present necessities; at the same time the evolution of certain indicators or data may sometimes be contrary to estimations.

The branch indicators allow the comparison of the analyzed enterprise with other enterprises from the same area with the purpose of estimating certain evolutions of the enterprise.

However, two enterprises which develop their activity in the same area may not be compatible (for example two units, whose object of activity is the extraction, retailing and selling wood, and respectively, furniture production). Another situation that doesn’t allow the use of branch indicators is that of groups and concerns whose subsidiaries develop activities in several branches. The financial characteristics of different subsidiaries belonging to the same group or concern are usually different, so they cannot be compared. Even if two enterprises are compatible, the possibility of using different accounting treatments or policies for the same economic operation or financial transaction- a possibility according to the international accounting regulations- leads again to the impossibility of using the branch indicators.

The partial fulfillment by the financial indicators of the established objectives is also motivated by:

- the use of alternative accounting methods.
- the heterogeneity of company’s exploiting activities. By considering the fact that the indicators are specific to the activity sector, for the enterprises that perform their activity in different domains, data and indicators comparability is made more difficult.
- the need of using the analyst’s argument. He/She has to use the argument when he performs an analysis of the indicators. The financial items cannot be used solely for the company’s diagnosis. To interpret the financial indicators it is necessary to consider the economic environment and the sector within which the unit develops its activity, the evolution of company’s activity and its objectives. When analyzing the impact of these factors on the interpretation of the financial items, the analyst can be sometimes subjective or lacking experience.

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