Industry Performance through the Creation of Value

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Abstract: In order to estimate the capacity of a company to produce valuable products, more and more precise devices need to be used. This will lead to the revealing of the sources and origins of value itself. The concept of the creation of value satisfies the definition of high performance, according to which performance means accomplishing the already established objectives. This concept must be regarded not only from the point of view of the shareholder, but also from that of all the parties involved in the company. Consequently, the term of value has been defined as value of the invested capital.

It is rather difficult to define the performances it is varied and multiple. Everyday, companies invent new competitive ways to face the competitors and therefore the performance is relative. A performing company creates value for its shareholders, takes into account its employees' opinion and protects the natural environment.

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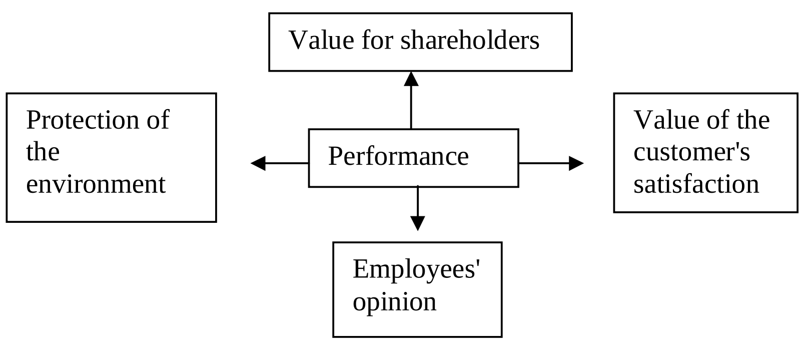

The main purpose of the present paper is to emphasize the achievement of the performance by means of maximizing the invested capital taking into consideration the fact that the absence of one performance indicator or the existence of multiple such indicator whose sizes cannot be quantified and compared makes the company's activity control very difficult.

Thus the preferential distribution of resources is the benefit of certain interest groups and shareholders ignoring the others.

A solution to this issue should be reconciliation between shareholders and the other groups of interest which would lead to a more responsible management and to a rise in the welfare of all groups of interest.

The above mentioned reconciliation determined an evolution of performance indicators which acted as guidance for the resource distribution activity.

Thus a transfer was made from performance indicators such as profits and income to indicators for the invested capitals.

Not any rise of income or profits is a good action to follow. These financial indicators do not take into consideration either the risk of the investments made by the company, or the opportunity cost of the capital meant to finance them. As a result, the profit has been replaced by performance indicators created for shareholders. These indicators contain a a larger amount of information concerning the efficiency of the company's activities and the restraints imposed by the economical domain the company is part of.

The financial indicators chosen to test the relevance of the value are those used traditionally to measure the performance of the organization, or those which are often considered having a direct or an indirect impact upon it.

In the estimation of the indicators the accountant's data are used made of the balance sheet as well as from the account of profit.

The value of the invested capital is represented by the present value of the future profits the shareholders can obtain form them.

Maximizing the value of the capital means placing the resources better and getting a bigger profit than the cost implied. As long as this condition is fulfilled the management of the company should follow the same direction. If the investments or the profit are not equally distributed, the opportunity costs of the resources involved should be taken into account within the analysis.

Also the risk of the investment should not be neglected.

The management centered on creating value for the shareholders, or on maximizing the value of the invested capital is known as management of value. Specialists have defined this kind of management in different ways. The management of values a system which is centered on the creation of value for the shareholders. Maximizing the value of the invested capital influences the strategy, the structure and the production process of the company and it guides the managers wages. It also establishes the indicators used to monitor the performance of the activity." (KPHG Consulting, 1999)

"The management of value is centered on the creation of value, not on the profits on paper. The value is obtained only when the company gets the profit that compensates the shareholders for their investment." (Christopher Rycls, 1999)

"The management of value is centered on maximizing the value of the invested capital through bigger profits than the cost of the capital. (Simmmb, 2001)

It is essential to underline the fact that the shareholders receive their profits only after all suppliers have been rewarded accordingly to the risks assumed by them. Consequently, maximizing the value of the company means maximizing the value of the invested capitals of the shareholders and maintaining the value of the attracted capital from other capital suppliers, function of the risks they assume.

The way the management of value is implemented differs from company to company and it is done in six steps or stages:

1) Choosing the objectives leading to the rise of value of shareholders.
2) Selecting the strategy and the design of the organization necessary to the fulfillment of the objectives.
3) Identifying the determinant factors of the creation of value.
4) Developing the action plans. Selecting the indicators of performance and establishing the aims starting from the priorities established through analysis.
5) Evaluating the success of the action plans and of the management performance, as well as that of the organization
6) Evaluating the validity of the objectives, of the strategies, of the action plans, of the control systems on the basis of the obtained results and modifying them according to the requirements.

According to Boston Consulting Group (1996) the factors involved in the rise of value are those variables which have an impact upon the value of the organization and which can be measured by the latter.

The financial indicators chosen to test the relevance of the value are those used traditionally to measure the company's performance or those usually considered having a direct impact upon it.

The accountant data from balance and profit accounts provided by the commercial companies are used when establishing the indicators.

The quality of the information contained within the financial rapports of the analyzed companies is conditioned by the accountant policies used , as well as the information within the company itself such as the financial administration. For example, the transition from costs to stocks using the same account methods (FIFO, LIFO, medium cost) . The lack of this information presupposes the existence of a certain compatibility at companies' level.

Not all the indicators used in the analysis are meant to quantify the company's profitability (MBE, GCA, CFD, PNA, CFD, CFE, ROI, ROE, ROA, PER, MB) , some of them conditioning it directly of indirectly. (AI, ACR, L, PANC).

Ways of Defining the Indicators of the Study of Company's Performance.

The total ratability obtained by shareholders (TSR, TOTALSHAREHOLDERS RETURN)-used to test the relevance of the information contained within the other financial indicators.

The proper estimation (MBE) representing the difference between the income from running and the costs of the operation, excluding those from payment. The MBE is analyzed as a percent from the business figure obtained by the company thus eliminating the inflation impact upon the indicator.

The rise rate of the business figure (GCA) is the estimated by comparing the business figure obtained a year before.

The level of net circular assets (ACRnete) is determined as the difference between the size of the circular assets (lasting less than a year) and that of the current duties (1 year limit). The actives and debts included in the financial balance are rather difficult to identify. In order to eliminate the scale issues, the ACRnete indicator should be analysed as a percent from the business figure. Thus the inflation impact on the size of the indicator is removed.

The size of assets (AI) represents the amount of the company's resources immobilized in the implied and unemployed assets (except the commercial founding)

Starting only from the information in the financial balance it is almost impossible to identify the types of fix means owned by the company, their state in order to establish their market value.

To remove the scale issues, the AI indicator is analyzed as percent within the business figure acquired by the company.

The size of the non included assets (PANC) is expressed within the whole financial activity. Thus the specific scale issues of the homogeneous samples from the point of view of the involved companies are removed.

Levrerul financiar (L) is seen as the rapport of the long and medium term debts made by the company and the capitals of the company itself.

The net profit on action (PNA) is the net profit of the company related to the number of actions issued by it. To avoid the scale issues, the size of this indicator is related to the stock exchange events.

The available cash flow (CFA) is calculated according to the formula CFD=EBIT(1-2)+AMO1-DIMO- DACRnete, (D - delta) EBIT - the Anglo-Saxon term gor "Earning Before Interests and Taxes" EBIT = the profit of the company includes all the income without the costs implied, except the interests for the already contracted credits.

The main advantage of CFD is that it reveals the creation of value. The main disadvantage is that when analyzed individually, its power diminishes, thus preventing compatibility between companies. To remove this issue it is recommended that relative terms should be used, such as the ratability interests.

The exploitation cash flow (CFE) is inferred from the net profit and the assets of the company.

The rentability of the invested capital (ROI) is seen as the rapport between the net profit and its net assets. In as far as the correct reflection of value through this indicator is concerned, most managers and investors think that a company creates value as long as ROI is bigger that the cost of the invested capital.

The main advantage of ROI is that when it is analyzed in terms if determinant factors of its level, it can provide useful hints concerning the weak or strong points of the financial administration. Thus the parts of company causing or destroying value for the shareholders can be identified.

Return on Equity (ROE) is the estimated financial rentability trough the net profit as rapport between the initial sums and the ones at the end of the financial operation.

Return on Assets (ROA) is the result of the net profit and the financial value of the whole asset of the company, seen as a average amount at the beginning and the end of the financial operation.

Price Earning Ration (PER) was selected taking into consideration the fact that the investor had quick access to the size of the profit, this indicator being displayed for the companies which are out of the capital markets.

Market to Book Ration (MB) is another indicator very often displayed on the capital markets.

According to these studies, for the investor who are dealing on the Romanian capital markets , the information provided be these indicators is not relevant. They do not make the investment division only by studying the information provided by the financial rapports.

This issue can be avoided by using a wider variety of financial indicators , or non-financial ones, thus taking into consideration a wider variety of information. However there is still the problem of standardizing and quantifying them.

The studies that have been made so far, have been modified due to the transition period in as far as the assets reevaluation, the size of the capital, the state of the already acquired companies by the AVAS.

In conclusion, "a company is like a tree: a part of it can be seen **-** its fruit**-** whereas another one is hidden**-** the roots. If we focus only on the visible part, the tree will die. In order to live and bare fruits, we have to focus on the roots that give it the necessary ingredients for life". (Edivinsson, Malone, 1977)

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