

EXPENDITURE ANALYSIS - PRE DIAGNOSIS COMPANY RESULTS

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Abstract:

In many fields of activity the most concrete form under which the competitive fight is carried on is the so-called "price war". In this case, the only form of long-term survival is to reduce the operational costs. Therefore, the accurate knowledge of the costs' level, of their training places and their size in the case of the competitors are vital to the company's management.

In the literature, in order to achieve the analysis of the costs' effectiveness, there are used a series of indicators of which the most representative, regardless of the level at which it is determined, is "the average costs" on the basis of which it is realized the analysis from 2012-2013. The theoretical concepts presented in a logical sequence are combined with the practical ones, the source of information representing a profit and loss account of the company Turism Covasna (listed on the Stock Exchange, Bucharest).

The results of the analysis are interpreted while trying to formulate some solutions to the economic and financial viability of the entity.

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1. Introduction

The expenditure analysis is a preliminary stage of diagnosing a company's performance because it facilitates the understanding of its results directly correlated with the dynamics, the structure and the efficiency of expenditure incurred by the undertaking economic activity (Mironiuc, 2006, p. 189). This analysis is particularly important in the management and control activities, because it highlights the way in which the resources (human, material, financial) are used and also their impact on the firm's performance allocation (Vâlceanu, Robu, Georgescu, 2005, p. 176).

According to International Accounting Standards, the expenditures are reductions in the benefits costs which are recorded during the accounting period by subtracting the value of assets or increase liabilities, which are reflected in the reduction of their own equity.

The cost of business, according to accounting regulations in force, are the amounts paid or payable for the consumption of stocks, works and services of the enterprise, the labor remuneration, the execution of legal or contractual obligations, including the cost of depreciation and the provisions established. The expenses for the normal course of business activity are the subject to two separate processing circuits of accounting:

1. *The financial accounting* which takes into account all the costs incurred by the company in order to establish the financial result.

2. *The managerial accounting*, which recognizes only certain expenses to the cost of production. They are grouped by destination, products, works, services (Bîrsan, 2004, p. 158).

Most of these expenses (the actual production costs and the additional expenses) give content to *the production cost*. The cost becomes an expense only as the economic resources available to the enterprise purchased or consumed in production processes become consuming values.

The analysis of costs and cost components that give content to the cost provides basic information for the company's management.

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In a modern view, the Western experts emphasise on the utility of the costs' analysis for each unit for generating the value because each activity has its own cost structure (*activity-based costing*). The cost optimization is provided by the cost effectiveness of any enterprise and its Management's ongoing concern (Mironiuc, 2006, p. 190).

2 The analysis of expenditure efficiency at the enterprise level and by categories of expenditure

The permanent insurance of the spending efficiency is a prerequisite for long-term growth performance of the company.

In the literature (Drucker, 2001, p. 59) states that the best cost control requires the reporting of resources to the results because costs do not appear by themselves, but are put in the service of achieving a particular outcome, and therefore what matters is not the absolute level of costs but the relationship between effects and results.

In this analysis, together with the spending growth it is also monitored their effectiveness which is in correspondence with the revenue they generate (Birsan, 2004, p. 179).

If one follows the correlation between income and expenditure they will notice that not all the spending generates income: only the operating expenses relate directly to the operating income. The financial expenses do not result in obtaining the financial income, but some of them (the interest expenses paid for credits) must be correlated with the income from the operations in order to assess the financial risk. The extraordinary expenses may relate in part or not at all to the extraordinary income.

A representative indicator for monitoring the effectiveness of spending, regardless of the level at it which shall be determined: total, by categories of expenditure (operating, financial, extraordinary, variable, fixed, materials, wages, etc.) on operating activities (cost centers) is *the average rate of expenditures (the average efficiency of expenditure, the income or the expenses from 1000 lei turnover)*, mirroring, regardless of the chosen name, resources consumption and their efficiency.

This indicator can be achieved by the following model:

$$\text{Average expenditure} = \frac{\text{Expenses}}{\text{Income}} \times 1000 \quad (1)$$

This indicator reflects the total expenditure needed to achieve 1000 RON total revenues. In order to reflect the efficiency indicator value there must be less than 1000 RON, respectively, in order to achieve 1000 RON total revenues, the total expenses required must be less than 1000 RON (Mironiuc, 2006, p. 195).

The essence of this indicator is that it provides information on the dynamics of income versus the expenditure dynamics. When the company expands its business, it is inappropriate to think that this will be achieved with a smaller amount of resources consumed in absolute value than the ones used in the previous activity. The problem is always relative, that costs may increase in absolute value, but their dynamics must not exceed the income growth, so to return to at least the previous period. Thus, in order to record a further result the index of expenditure must always be exceeded by the revenue development index.

Therefore, by using the rate of spending as a source of information and not the absolute value of spending, the information obtained will be used for future business activity management.

A specific element of this indicator is that it is calculated as a ratio between an indicator of effort (a type of expenditure) and one that expresses effects (specific income), the reduction of the average rate of expenditure reflects the increasing efficiency of the company, as increased means reducing the efficiency of the company (Vâlceanu, Robu, Georgescu, 2005, p. 182).

Consequently, in order to increase the total expenditure efficiency, the manager of the enterprise should promote measures that will result in the faster growth of the total revenues compared to the total expenditure: a better use of the existing production capacities by reducing the output fluctuations; choosing clients with stable demand so as to ensure the sales and the operating income growth; designing products with a low cost; an increased focus on the quality of inputs purchased from suppliers, the labor productivity growth; reducing the specific consumption per unit of product; the realization of investments in technologies etc.

In order to exemplify the methodology for analyzing the efficiency of spending in Turism Covasna company we use the data in table no. 1.

Table no. 1. Level and dynamic of efficiency costs

Indicators	Financial year		Δ	(%)
	2012	2013		
Operating revenue	11528 893	10991 900	- 536993	95 .34
Operating expenses	10640 628	10531 693	- 108935	98 .98
Financial income	79543 0	65427 1	- 141159	82 .25
Financial expenses	14719 51	25045 59	+1032 608	17 0.15
Extraordinary income	0	0	0	-
Extraordinary expenses	0	0	0	-
Total revenues	12324 323	11646 171	- 678152	94 .50
Total expenditure	12112 579	13036 252	+9236 73	10 7.63
The average operating costs	922.9 5	958.1 3	+35.1 8	-
The average financial costs	1850. 51	3828. 01	+1977 .50	-
The average extraordinary expenses	0	0	0	-
The average total expenditure	982.8 2	1119. 36	+136. 54	-

Source: author's contribution

The calculation of the *total expenditure elasticity* with respect to the total income can bring more information on cost effectiveness, as follows:

$$E_{Ch/Vt} = \frac{ICh_t - 100}{IV_t - 100} = \frac{107.63 - 100}{94.50 - 100} = -1.39$$

According to the table above we can draw the following conclusions:

Regarding the cost effectiveness on categories, there is a favorable situation in the operating activity in terms of the level indicator ($\overline{RCh_e} < 1000$). In the dynamic, on the other hand, the indicator shows an upward trend (+35.18%), a situation considered to be unfavorable due to the decrease in faster operating income (-4.66%) compared with the rate of development of the operating expenses (-1.02%).

In the financial business activity, the situation is unfavorable from the point of view of the efficiency of spending in both periods (the values are greater than 1000 RON and in development), which does not allow a saving/spending cuts ($R = 1000 - \overline{RCh_f}$). This is due to the increased financial costs by 70.15% as a consequence of the falling by 17.75% of the financial income.

The total economic activity of the company is also unfavorable (the average spending is higher than 1000 in the year 2013 and an there was an increase of 36.54%), due to the fact that the pace of total expenditure (+7.63%) exceeded the incomes (-5.50%).

The coefficient of elasticity of the total expenditures with respect to the total income ($E_{Ch/Vt} = -1.39$) indicates a 1% increase in the total spending, the total revenues are reduced by 1.39%, which explains the decrease of the efficiency of the spending total.

3. The analysis of the effect of increasing/reducing company spending efficiency

In order to reflect the \overline{RCh} indicator should register values lower than 1000 RON. Only then it is possible that in 1000 RON incomes to be covered the expenses incurred in obtaining them and to achieve savings (reduction) of costs ($R = 1000 - \overline{RCh}$), which are actually the profits from 1000 RON revenue. The economy (the reducing) in spending can be obtained by all the incomes and expenses or by categories of income and expenses. As the economy (the reducing) the cost is higher, the benefit will be greater. Thus, depending on the values of the indicator, one can identify the following situations:

a) $\overline{RCh} < 1000 \rightarrow 1000 - \overline{RCh} = R$ - company records to 1000 RON income benefits;

b) $\overline{RCh} = 1000 \rightarrow 1000 - \overline{RCh} = 0$ - the firm is in equilibrium point, the revenues fully cover their expenses and the profits or losses are not recorded;

c) $\overline{RCh} > 1000 \rightarrow 1000 - \overline{RCh} = -R$ - the enterprise's revenues cannot cover the costs of their production and the income losses in 1000 RON.

The effect of the increasing/reducing total expenditure efficiency translates to 1000 RON income benefit/loss on the total revenue derived from the enterprise activity and it can be determined by applying a simple rule of three, according to the following model:

$$\begin{array}{ll} 1000 \text{ RON income} \dots\dots\dots & R = 1000 - \overline{RCh} \\ Vt \dots\dots\dots & B = ? \end{array}$$

Consequently, the effect of the increasing/reducing total expenditure efficiency at 1000 RON revenue (B) is:

$$B = \frac{Vt}{1000} \times (1000 - \overline{RCh}) \quad 2)$$

Corresponding to this model analysis, the increase of the benefit ($\Delta B > 0$) is a consequence of the economic growth (reduction) of costs or the increase of the efficiency of the total expenditure 1000 RON total revenues ($\Delta \overline{RCh} < 0$) and the effect of increasing the total revenues ($\Delta Vt > 0$).

By analogy, the effect of increasing/reducing the efficiency of spending to 1000 RON turnover (B) is:

$$B = \frac{\text{Turnover}}{1000} \times (1000 - \overline{RCh}) \quad 3)$$

The increase of the efficiency of expenditure turnover ($\Delta \overline{RCh} < 0$) as the increase in turnover ($\Delta Ca > 0$) drives favorable development benefit ($\Delta B > 0$) (Mironiuc, 2006, pp. 205, 206).

In the same way, we can determine the effect of increasing the efficiency of the operating expenses, the financial and the extraordinary, and the benefits, respectively.

In order to illustrate the methodology for analyzing the effect of increasing/reducing the total spending efficiency in Turism Covasna company we used the data in the table below.

Table no. 2. The analysis of the effect of increasing/reducing the spending efficiency

Indicators	Financial year		Δ	(%)
	2012	2013		
The average operating costs	922.95	958.13	+35.18	-
The average financial costs	1850.51	3828.01	+1977.50	-
The average extraordinary expenses	0	0	0	-
The average total expenditure	982.82	1119.36	+136.54	-
The effect of reduced efficiency in operating expenses	888265	460207	-428058	-
The effect of reduced efficiency of financial expenses	-676521	-1850288	-1173767	-
The effect of reducing total expenditure efficiency	211744	-1390081	-1601825	-
Result of operations	888265	460207	-428058	51.81
Financial result	-676521	-1850288	-1173767	273.50
Gross result	211744	-1390081	-1601825	-

Source: author's contribution

According to the table above we can draw the following *conclusions*:

In both periods analyzed, the indicator of efficiency in operating expenses are below 1000 RON, reason for which the company records benefits of 77.05 RON to 1000 RON in operating incomes (1000-922.95), respectively, 41.87 RON to 1000 RON in operating incomes (1000-958.13). The effect of operating the expenditure efficiency is the rewards of the company's operating income of 888 265 RON in 2012 or 460207 RON in 2013.

Regarding the company's financial activities in both periods analyzed, the indicator of efficiency in financial expenses exceeds the limit of 1000 RON, reason for which the company recorded a loss of 850.51 RON to 1000 RON in operating income (1000-1850.51), 2828.01 RON to 1000 RON in operating income (1000-3828.01). The effect of the inefficiency of the financial expense is represented by the company's financial income losses of 676521 RON in 2012, respectively 1850288 RON in 2013.

In 2012, the total expenditure efficiency indicator remains below 1000 RON, reason for which the company recorded benefits of 17.18 RON to 1000 RON in income (1000-982.82). The effect of the total expenditure efficiency is the profit of the company's total revenue, respectively 211744 RON.

In 2013, the total expenditure efficiency indicator exceeds the limit of 1000 RON, reason for which the firm lost 1000 RON in revenues of 119.36 RON (1000-1119.36). The effect of the inefficiency of the total expenditure losses is the total income of the company, respectively 1390081 RON; there is therefore a worsening economic and financial situation of the company in 2013.

Conclusions

The analysis of the data on company's expenses highlights some relevant issues concerning the evolution of the various categories of expenditure, facilitating, through a deviation analysis, the control over the enterprise's resource management.

In terms of increasing the efficiency of spending on the company's activities and it is recommended a more careful and detailed analysis of how the company's resources should be used in order to increase its profitability (improving sales activity, rising prices, reducing costs, outsourcing support operations, increasing efficiency, efficient planning of activities, selling products/services with high profit margins etc).

As a final conclusion of this article, it can be seen that there is an increase in the inefficiency of costs on both categories of the analyzed company, caused, on the one hand,

to the reduction in the operating income, the financial assets, combined with the increased expenditure, adversely affecting the enterprise's results. Knowing that the cost optimization is provided by the cost effectiveness of any enterprise, the decision makers within the company must take urgent measures in order to streamline the costs and to avoid undesired situations.

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