ECONOMIC FINANCIAL INDICATORS AFFECTING THE PERFORMANCE OF CONSTRUCTION COMPANIES

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Abstract

At any moment, companies are faced with choices. Making a decision is not something very easy, because there is always uncertainty. Decisions become even more difficult when the business climate is not at its best. The great difficulties in which the economy finds itself make it even more difficult to make a decision. In such a climate of uncertainty, the need to make economic-financial decisions is very great. There are precisely these decisions that make a company successful. In general, the decisions that an enterprise faces during the exercise of its activity are related to sources of financing, expenses and income, these decisions have as a logical basis the information extracted from the financial analysis. Financial indicators expressed in numerical values, generated by financial analysis, serve as guidelines for the actions taken by company managers, in order for them to realize their objectives for profit maximization and company growth.

The purpose of this paper is to familiarize with the financial analysis and its importance for the decision-making of companies and the management of profits. This overview study will be concretized through the analysis of the financial reports of a construction company[2]. Through the horizontal analysis, based on the financial reports for two years (2018/2019), including the main items of the financial statements, it will be seen that these items have increased every year. Sales revenues have increased in total, looking at the latest statements. The net profit has increased, where this has come as a result of the continuous increase in sales by the company and the opening of new branches in the districts.

Key words: Albania, Construction Industry, Data Analyses, Horizontal Analyses, Financial Reports

Introduction

In the conditions of the market economy, the ways of organizing and directing production are different. One thing is the same: the existence of many types of property and their different sizes dictates different ways of managing them. Both forms of property, private and state, are subject to the laws that originate from them. The profit they realize is an important indicator for them, as long as it is the final goal of the companies. Commercial companies operate in conditions of

[2] For the company's financial statements, contact the authors (for data privacy reasons).

competition, with each other. There are also financial relationships between society and the population that make it possible for consumers to react to the quality, price and side effects of society in the macro-economic and social environment where it operates. Companies are always under the pressure of the law and the state, in whose name and on whose account several links act, such as the tax bodies, the control of accounts, the financial police, the treasury, etc. The financial management of commercial companies must be done by recognizing and respecting these links, otherwise it is destined to face the state.

Analysis of financial statements constitutes a set of tools, analytical techniques and methods necessary for business analysis. It is a diagnostic tool for evaluating financing, investment and operating activities. Also, it is an evaluation tool for management decisions and other decisions of the company. Financial statements are kept by companies periodically and are used to help manage the business. The financing methodology used by the interested parties to maintain business activities and to evaluate financial performance is the same. Therefore, to isolate some financial performance metrics, the analysis of financial ratios is mainly used.

The purpose of this study is to familiarize with the financial analysis and its importance for making decisions in the company and managing its profits. More specifically, during the analysis, the reports of the short-term and long-term solvency of the construction company, the analysis of the degree of financing of the activity and some other important indicators such as liquidity will be calculated.

Literature review

The financial sector is presented comprehensively, such as financial instruments, financial markets, but also the legal and regulatory framework that makes it possible to carry out credit transactions. It can be said that the development of the financial sector is related to overcoming the "costs" of a financial system. This step of reducing the costs of obtaining information, concluding contracts and making expenditures ends up in the emergence of financial contracts, financial markets and financial intermediaries. Different types and companies of information, sellers and costs of information in relation to different legal, regulatory and tax systems have driven the closure of many financial contracts, financial markets and financial intermediation in different countries throughout history.

The five main functions of a financial system are: (i) producing extensive information about large and dispersed capital investments; (ii) monitoring investments and corporate governance exercises after securing finance; (iii) facilitating trading, diversification and risk management; (iv) mobilization and accumulation of savings; and (v) facilitating the exchange of goods and services.

According to Issa and Noureddine (2023), the theoretical relationship between financial development and macroeconomic variables has been empirically verified by many previous studies. Most of the studies have separately analyzed the impact of financial development on economic growth, inflation and employment in different groups of economies and in different time intervals. According to Rashita (2023), some studies have focused mainly on the direction of causality, while some other studies have focused on the qualitative and quantitative effects of financial development (Christopoulos and Tsionas, 2004; Wadud, 2009; Rachdi and Mbarek, 2011). Nawaz and Ohlrogge (2022) note that their study confirms the strong relationship between financial development, economic growth and macroeconomic variables. This study is important because it investigates the impact of financial development simultaneously on three macroeconomic variables such as economic growth, inflation and employment.

However, studies in recent years have shown the non-final impact of financial development on economic growth. Some studies have found a positive impact (Yusuf et al., 2020), while some other studies have found a negative impact (Collin and Jahed, 2023) but there are situations of neutral impact (Chang, 2002; Okwor et al. 2023) of financial development in economic growth. But on the other hand, Altuzarra, Bustillo and Rodríguez (2022) suggested that financial development positively affects economic growth only if inflation falls below its threshold. Conversely, if inflation goes beyond the limit, financial development has no effect on economic growth. According to Salas and Odell (2022) there is no abundant literature on the relationship between financial development and inflation.

But financial development is estimated to affect the level of employment. Tayeh et al. (2018) analyzed the interaction between the development of the financial sector more liquidity and the level of employment of the labor force. From where the results showed that the strict criteria in the credit sector brought a low credit lending, making it difficult for firms to create more job opportunities, which also brought the deterioration of the general level of employment. But on the other hand, Kasabreh and Tarawneh (2021) has presented empirical evidence to prove the positive relationship between financial development and employment. In the same way, Ehigiamusoe et al. (2019) have reported a positive relationship between financial development and employment. This study has shown that the literature on the finance-economic growth link is widely available, but the impact of financial development on inflation and employment is very limited. Since the financial crisis is mainly related to the financial sector, the analysis of the financial sector and related fields is valuable nowadays. The question that arises is whether the intensified and deepened financial market can be a consequence or a reason to influence (positively or negatively) employment, inflation or economic growth?

Numerous empirical studies have analyzed the impact of financial development on economic growth, inflation and employment growth in countries but also in different time intervals using diverse assessment techniques. In these studies, different variables, theoretical models, econometric techniques, different types of data, different time horizons, etc., were used to develop the empirical analysis, without reaching final results. It is argued that financial development not only accelerates economic growth (Bist, 2018), but also generates employment and reduces poverty and income inequality, especially in developing countries (Čižo, Lavrinenko, Ignatjeva, Danilevica, et al., 2020). According to the studies of Abramova et al. (2022), it is noted that financial development promotes growth but also increases employment through capital accumulation and technological innovation. While studies have often found mixed results regarding the empirical relationship between financial development and employment (Alhammadi, et al. 2021).

But on the other hand, many studies have emphasized that the improvement of the credit market affects the increase in employment stability (Wen, 2021). Ayadi et al. (2015), showed in their study that credit growth affects employment growth. However, financial development can reduce employment, because the reducing effect of financial development is related to several factors, such as the choice of measure of financial development, labor market regulations, union density and coordination of wage bargaining power, but also if workers are skilled or not (Fernández and Tamayo, 2017). Kim and Lim (2018) showed that employment also decreases with market concentration and rigid market regulation. Whereas Cheng et al., (2021) reach the conclusion that financial development has no significant relationship with employment. Raifu (2019) raised the thesis that since there is no comprehensive conclusion in the existing studies, it is very necessary to research the effect of financial development on the level of employment. In the modern globalized world, the financial sector is considered the backbone of the economy Sharma (2020), in this line it is essential to empirically analyze whether the intensified and deepened financial market positively or negatively affects macroeconomic variables, such as economic growth, inflation and employment (Park and Shin, 2017).

Methodology

To effectively analyze a company's financial statements requires an understanding of three main areas, such as the structure of the financial statements, the strategies that the firm follows to differentiate itself from its competitors, and knowledge of the economics of the industry in which the company operates.

There are six steps that must be followed to perform an analysis of financial statements effectively.

Identification of the economic characteristics of the industry - First, the industry in which the firm operates must be assessed - the chains of activities involved in the company, including the analysis of the company's products. In this step, techniques such as Porter's Five Forces or economic attribute analysis are used.

Identifying the company's strategy - The analysis should include the nature of the company's product/service, analyzing the product, its profit margin levels, brand loyalty and cost control. Of course, in this step, features such as industry chain integration, geographic diversification and industry diversification should be taken into consideration.

Assessing the quality of the firm's financial statements - Reviewing the main financial statements within the context of relevant accounting standards is important.

When reviewing balance sheet accounts, issues such as recognition, valuation and classification are key to proper valuation. The main question should be whether this balance sheet is a complete representation of the economic position of the firm. When evaluating the income statement, the main point is to properly assess the quality of the income as a complete representation of the economic performance of the firm. Evaluating the statement of cash flows helps in understanding the impact of the firm's liquidity position from operations, investments and financial activities during the period, basically, where the funds come from, where they went and how the overall liquidity of the affected firm was.

Analyzing current profitability and risk - This is the step where financial professionals can really add value to the evaluation of the firm and its financial statements. The most common tools of analysis are key financial statement ratios related to liquidity, asset management, profitability, debt management/coverage and risk/market assessment. Regarding profitability, two broad questions must be asked: how profitable are the firm's operations relative to its assets-regardless of how the firm finances those assets-and how profitable is the firm from the perspective of equity shareholders. Finally, it is important to analyze each financial statement ratio in a comparative manner, looking at current ratios relative to those of prior periods or relative to other companies or industry averages.

Preparing projected financial statements - Although often challenging, financial professionals must make reasonable assumptions about the future of the firm (and its industry) and determine how those assumptions will affect both cash flows and funds. This often takes the form of pro-forma financial statements, based on techniques such as the percentage of sales approach.

Firm valuation - While there are many methods of valuation, the most common is some type of discounted cash flow methodology. These cash flows may be in the form of anticipated dividends, or more detailed techniques such as free cash flows to equity holders or to enterprises. Other approaches may include the use of relative valuation or accounting-based measures such as economic value added.

After the analyzes of the firm and its financial statements are completed, there are further questions that need to be answered. One of the most critical is: "Can we really trust the numbers being offered?" There are many reported cases of accounting irregularities. This is called aggressive accounting, where income management or direct financial reporting is important for financial professionals to understand how these types of manipulations are carried out and more importantly, how to detect them.

The paper focuses on the financial analysis of a construction company and is based on the collection of primary and secondary sources. The primary sources of the study are data provided by National Business Center about the company's balance sheets, but the analytical method was also followed for analyzing and comparing the data with reference to different publications in the literature. The paper is descriptive and analytical, as it describes and analyzes a very current topic. The paper has made extensive use of reliable sources in order to reach a conclusion about the current situation as objectively as possible and has used the deduction method.

Results

In this study, financial statement analysis is used as a method of reviewing and analyzing a company's accounting reports (financial statements) in order to evaluate its past, present or projected future performance. This process of reviewing financial statements enables better economic decisions to be made. The main purpose of financial statement analysis is to use information on the past performance of the company in order to predict how it will happen in the future. Another important goal of financial statement analysis is to identify potential problem areas and solve their problems. The main types of financial statements are: balance sheet, income statement and cash flow statement as well as owner's equity statement. Vertical analysis is limited in that it uses a single time period, therefore, it has the disadvantage of losing comparisons to different time periods to assess performance. This can be addressed by using it in conjunction with timeline analysis, which shows what changes have occurred in the financial accounts over time, as a comparative analysis over a given period.

Vertical analysis. Total assets in 2019 reach the value of ALL 186 063 162, which is significantly affected by short-term assets that occupy 95.69% in the amount of ALL 177 180 189 and long-term assets occupy 4.77%. While the total assets in 2018 reach the value of ALL 84 876 448, which is significantly affected by short-term assets that occupy 89.69% in the value of ALL 76 126 833 and long-term assets occupy 10.31%. Total liabilities in 2019 reach the value of ALL 128 042 827, which are 100% affected by short-term liabilities worth ALL 128 042 837 and long-term assets occupy 0%, since the leasing loan for the purchase of vehicles has been fully liquidated. Against total liabilities in 2018, they reach the value of ALL 76 417 624, which is significantly affected by short-term liabilities with the value of ALL 74 098 331 and non-current assets with a value of ALL 2 319 293.

Capital and reserves in 2019 reaches the value of ALL 58 020 322 and the most significant weight is the increase in the net profit of this fiscal year in the amount of ALL 58 020 323. While the capital and reserves in 2018 reach the value of ALL 8 458 824, and the most significant weight is occupied by retained earnings with a value of ALL 6 705 358, the profit of the fiscal year with a value of ALL 1 753 367, where all the undistributed profit of 2018 and before is distributed to the partners by decision of the assembly during 2019.

In the construction company, from 2018 to 2019, sales revenue has increased. The gross profit of 2019 is 26.73 times more than the profit of 2018. From this, it can be seen that the profit before tax has a very significant increase from 2018 in 2019. The increase in profit comes as a result of the increase in income from exploitation activity with a value of ALL 216 814 948 or an increase of 312.56%. In the expenditure items, the most significant weight is occupied by the cost of goods sold with an increase of 32.02%. The net profit of 2019 is 33.09 times more than the profit of 2018. From this it can be seen that the profit after tax has increased significantly from 2018 to 2019.

Horizontal analysis. Horizontal or otherwise comparative analysis serves to compare the financial information of a company with historical financial information of the same company during a reporting period. It can also be based on reports derived from financial information for the same time span. The main purpose is to see if the numbers are high or low compared to past data, which can be used to investigate any cause for concern. For example, certain costs are currently high, but being under budget in previous years may cause management to investigate the cause of the cost increase, this may be due to switching suppliers or material usage first with the best quality.

In the company used for the analysis, it is noted that from 2018 to 2019, sales revenues have increased. The increase in income from 2018 to 2019 indicates a significant growth of the company during this year. The gross profit of 2019 is 26.73% times more than the profit of 2018. From this it can be seen that the profit before tax has a very significant increase from 2018 to 2019. The increase in profit comes as a result of the increase in income from the activity of utilization with a value of ALL 216 814 948 or with an increase of 312.56%. In the expenditure items, the most significant weight is occupied by the cost of goods sold with an increase in value of ALL 3 016 889 or with an increase of 32.02%. The net profit of 2019 is 33.09 times more than the profit of 2018. From this it can be seen that the profit after tax has increased significantly from 2018 to 2019.

Conclusions

Through this paper, it can be concluded that the construction industry has a strong connection with the economic growth of a country, therefore it is seen as necessary to periodically carry out financial analyzes in this industry. Financial statements are related to each other, because they receive data from each other. For example, the statement of financial position takes from the statement of changes in net capital, the capital on the date of construction of the statement of financial position (at the end of the period), while the statement of changes in capital takes from the statement of performance the amount of realized net profit during the period, while the cash flow statement takes from the statement of changes in investment capital and owner's withdrawals, etc. The four statements together provide in a complete and systematic manner the financial information that third parties need about the economic entity, regardless of the size of the entity.

The analysis of the reports also presents some limitations in its entirety. These restrictions are firstly related to changes in accounting policies. For example, the use of different methods of amortization of assets, which will affect profitability ratios and return ratios. It may happen that the management of the unit intentionally manipulates the data, for example, it may reduce the necessary expenses for research, in order to increase the net profit. It is understood that this practice damages the economic unit in long-term periods. The report does not determine the quality of its zeros. For example, a high liquidity ratio may come in part as a result of accounts receivable that have not been collected. Likewise, economic units may have several business segments of different natures. This makes it difficult to determine the industry in which the economic entity should belong. Under these conditions, industry averages are only approximations and analysis based on comparison with them is subjective.

Through the horizontal analysis, based on 2018, and including the main items of the financial statements, it is observed that these items are increasing every year. Revenues from the sale (2018 is taken as the basis), have increased in total, looking at the last statements declared. The net profit has increased, and this has come as a result of the continuous increase in sales by the company and the opening of new branches in the districts.

The average collection period has decreased which means that there is a good chance that some of the accounts receivable will not turn into bad debt. The company works with contracts. The net profit margin has increased as a result of the reduction of operating expenses (salary expenses, office expenses, departures abroad, departures of the board of directors abroad, other expenses related to transport vehicles, staff training abroad, etc.) so there is a good growing financial position. Gross Profit Margin also best shows that the company has very good costs compared to the selling price. According to ROE it is shown that the firm is generating profits for its shareholders.

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