BUSINESS RISK DIAGNOSIS IN SC COSM-FAN CARMANGERIE SINNICOARA CLUJ

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Abstract. Causes leading to one or another type of business risks follow in and converge leading to the payment inability of the company. The first wrong step starts from excessive costs diminishing the added value and generating an insufficient profitability. Low profitability negatively influences the self-financing ability, which becomes insufficient as compared to the investment performed. All of these influence cash flow that, being insufficient, leads to the company getting loans. The loans incur financial costs that add to the already existing ones and at the same time affect the entity solvability – the financial condition of business survival. Putting a diagnosis to the economic risk by means of financial leverage or the financial lever effect, where the lower the financial leverage value, the lower the operation risk. Putting a diagnosis to the economic risk by means of financial leverage as an effect stabilizes only the influence of indebtedness over rate of return on self-owned capital, and the influence on the net outcome of changing by one percent the operating result affected by financial costs, respectively. The SWOT analysis and rating analysis applied to partial diagnosis as a consequence of repeated market dysfunctionalities encountered by the economic agent allow a quantity and quality approach of the analyzed aspects.

Key words: financial leverage, financial profitability, bankruptcy.

Generally speaking, risk is the possibility that an event might occur that may jeopardize the activity of the company. For our assessed economic agent, risk represents its incapacity to adapt along time and at the lowest cost to environmental changes. Risk expresses the volatility of the economic result under the operating conditions. Putting a diagnosis to the risk of the economic unit implies to assess and put a diagnosis to the following risks: the economic or operating risk, the financial risk and the bankruptcy risk.

MATERIAL AND METHOD

The means and instruments used are according to the assessment direction. In order to asses the financial balance and bankruptcy risks the analysis of balance sheet ad financial flow scheme is mandatory by the method of rates and treasury relations. The study of financial performance requires the analysis of Result Account by: rate method, the evolution of the activity amount effect on the result, as well as by increasing management balances. For final results the Swot analysis together with the rating analysis are applied.

RESULTS AND DISCUSSIONS

1. Operating risk can be assesses by using:
- breakeven as the point where the turnover covers operating costs, limited within fixed and variable costs, calculated in unit values for the entire economic unit.
- "position indicator" (according to Miculescu M., 2003), an indicator assessing the economic risks associated with the company.

Table 1

Indicators of development risk

Indicators (thousand lei)	Financial year			
	2008	2009	2010	2011
Turnover	12200	18170	24303	24052
Variable Costs (VC)	11567	16899	22593	22322
Fixed Costs (FE)	289	905	969	1083
Operating Results (OR)	344	366	741	647
Variable Contribution Margin	633	1271	1710	1729
Relative Cost Margin	0.051	0.069	0.070	0.071
Critical Turnover (CT)	5569	12943	13774	15059
Operating (commissioning) Leverage	1.84	3.47	2.30	2.67
Absolute Position Indicator	6631	5227	10530	8993
Relative Position Indicator	1.19	0.40	0.76	0.60

Source: author's drafts

-The critical turnover corresponding to the point of balance grows by the year.
- variable cost margin points out a part that stays as a part of the turnover after variable costs have been

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covered, in order to cover fixed costs and generate a certain measure of operating outcome.
-the relative margin on variable costs is of only 5.18% in 2008 because of high variable costs, however this margin is powerful enough to cover fixed costs of 2.36% of the turnover.
- variable costs are higher every year, the same as fixed costs, except for the last year, when rates are slightly going down, and the financial and economic outcome as well.
-the operating leverage reaches its highest rate in 2009, namely a 3.47 elasticity coefficient, when fixed costs are larger and the economic risk is higher because of low flexibility to market variation. During the second part of the interval fixed costs are higher but slightly remote from variable costs margin, and the closer they get to this margin the risk might occur that the result got close to zero.

The rate of fixed costs getting closer to the variable costs margin rate amplifies the operating or economic risks.
-low rates of position indicator in terms of both absolute values and relative value point out a greater risk, especially in 2009, and the larger rates obtained during the rest of the years present a lower economic risk, which means a poor flexibility of the entity to company requirements.
-the highest volatility to operating conditions is recorded in 2009, however the company is situated in a comfortable position as position indicator exceeds the breakeven by 20% in each of the assessed periods. This rating is based on statistical studies (Cişmaşu, I.D., 2003, *Risk – Element in decision substantiating*, Economic Publishing House, Bucharest, p.80 – according to Verniment, P., 1988, *Finance d' entreprise, Analyse et gestion*, Editions Dalloz, Paris, p.212.).

Table 2

Economic Risk Diagnosis

Breakeven	Interpretation /causes	Swot Diagnosis	Score
Net Turnover exceeds breakeven by more than 20%	Low economic risk	Strong Forces/ Maintain	4

Source: author's drafts

2. The financial risk of the entity considers the fluctuation of results under the incidence of financial structure of the company.
There are two ways of approaching the financial risk: global profitability or "critical" point taking in account financial expenses (costs with bank interest), that can be considered fixed costs. The second approach is the indicator of net turnover rate as compared to overall profitability.
The model of analysis involved is the "financial leverage" or the "financial lever effect". It is the most adapted model as it simplifies the real situation of the company in order to establish the degree of indebtedness as follows:

- For the calculation of financial profitability only the operating activity is considered and
- Only financial expenses influence the net result.

In the event the economic profitability rate exceeds the average interest rate, the financial leverage effect is a positive one; therefore the payment of its own capital is done at a rate superior to the payment of debts.

The positive difference between economic profitability and average interest rate allows indebtedness to increase financial profitability rate. Where the economic profitability rate is lower than average interest rate, the financial leverage effect is negative therefore the risk incurred by the business owners resides in the payment of debt exceeding the payment of self-owned capitals.

Similarly to operating risk, a dynamic assessment of financial risk can be obtained by the financial leverage coefficient reflecting the percentage by which the net result modifies as compared to a 1% change in operating results as influenced by financial costs.
Financial risk occurs when the correspondent of a 1% decrease in operating results is more than 1% of the net outcome.

Table 3

Impact of Financial Leverage upon Risk

Indicator	Financial Year			
	2008	2009	2010	2011
Financial Profitability	8.24	1.52	29.17	20.96
Economic Profitability	2.83	3.17	6.02	5.51
Average Interest Rate	2.26	3.35	2.73	1.99
Indebtedness	9.51	8.98	7.02	4.39
Effect of Financial Leverage	5.41	-1.65	23.15	15.45
Operating Result (thousand lei)	344	366	741	647
Net Result (thousand lei)	95	18	447	456
Coefficient of Financial Leverage	-	-12.88	23.81	-0.14

Source: author's drafts

-indebtedness implies a positive financial leverage effect as economic profitability exceeds the average interest rate, therefore the financial profitability rate is superior to the economic profitability rate.
-for financial year 2009, under the influence of economic profitability below the average interest rate, the effect of financial leverage rate is negative, of -1.65, the same with the difference between financial profitability and economic profitability. This situation is generated, on the one hand, by an inefficient use of assets and, on the

other hand, by the debt increase, resulting in interest rate growth.

Financial risks are noticed to worsen in the periods between 2008-2009 and 2010-2011. During the last mentioned period, a 1% decrease of operating results equals a 0.14 in the net results.

Table 4

Financial risk diagnosis

Financial Indicator Leverage Effect	Interpretation/ causes	Swot Analysis	Score
Rate of Economic Profit	Low financial risk: Average rate of 4.15% exceeds the average interest rate of 2.53%. The situation is favorable to the owners, and financial profitability is increasing as compared to the rate of indebtedness. The company may still get credits.	Strong situation/ Improvement	4.5

Source: author's drafts

3. Bankruptcy risk of the entity treated as a "method of foreseeing bankruptcy risk", the method of scores (Berheci. M., 2010, *Capitalizing Financial Reports*, CECCAR Publishing House, Bucharest, p.493; according to Cohen. E., 2004, Analyse financiere 5^{e}edition, Economica, Paris, p.481)

The method of rates is based statistical techniques and rate analysis. The score method gathers companies on profitable units or companies with different levels of financial difficulties.

To the analyzed study three assessment models of bankruptcy risk apply, data as displayed below.

Table 5

Assessing bankruptcy risk

Indicator	Financial year			
	2008	2009	2010	2011
Score function - E. Altman model	0.53	1.14	2.20	2.26
Score function - Conan & Holder model	0.02	0.02	0.13	0.12
Score function – Central models of France Balance Sheets	2.206	1.821	1.075	1.196

Source: author's drafts

E. Altman model: the first assessed period situates the company under undoubted risk of bankruptcy, and the second assessed calendar period shows the company facing financial difficulties.

The Conan& Holder model: from 2008-2009, the company's risk of bankruptcy is of 65%-90%, and during the last period the situation improves, the risk of bankruptcy being 10%-30%.

The model of Balance Sheet Central Scheme of French Banks situates the bankruptcy risk of the company at 30.4% during the following three years, for financial years 2008 and 2009. For the next assessed periods, bankruptcy risk is as low as 3.2%.

Table 6

A synthesis of risk diagnosis

Indicators	Swot diagnosis	Score	Importance Weight	Aggregated Score
Economic Risk Diagnosis	Strong position - same	4	P1=30%	1.20
financial risk Diagnosis	Strong position improvement	4.5	P2=70%	3.15
Economic and Financial Risk Diagnosis	Financial profitability determined includes total entity debts		100% (4-4.5)	4.35

Source: author's drafts

CONCLUSIONS

- The point of equilibrium is not a static concept; there is no absolute critical point, there is a breakeven with a certain calculation horizon.

-Entities holding high fixed costs face a higher degree of risk, as flexibility to market variations are very low.

-Knowing the elasticity coefficient is necessary for the company management to make decisions as of: determining turnover rate, cutting down variable cost rate or the selling price rate to obtain a certain profit.

-The financial leverage model is a useful tool that enables the optimization of company's financial structure.

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