PROFITABILITY AS A CRITERION FOR ASSESSING ECONOMIC EFFICIENCY

Krakowiak I., master student
Scientific quarry **– V. Vovk**, dr, adiunkt
Stanisław Staszic State University of Applied Sciences in Piła

The assessment of the financial condition of economic entities is driven by the need to improve management processes and the participation of these entities in the market economy [1]. The analysis of the financial situation is used both by the managers of the economic entity and by external observers. The most effective tool for assessing the financial situation of an enterprise is ratio analysis, covering: profitability, liquidity, operating efficiency, debt and debt servicing efficiency. For an external observer, the profitability ratios are the most relevant, as they report on the fact that revenues exceed operating costs. This is because a lack of profitability over a long period of time will first cause stagnation and may then lead to the bankruptcy of the company.

A number of approaches can be found in the economic literature to assess the profitability of a company. According to J.Zabawa, the basic profitability indicators should include profitability of assets, profitability of equity and profitability of turnover [2]. A study conducted by T.Felczak indicates that the profitability of assets and profitability of equity are the most important indicators in assessing profitability [3]. At the same time, we see that there are also studies where economists indicate that it is sufficient to assess only one of the possible profitability indicators, e.g., return on assets [4] or return on equity [5].

The profitability of a company is a parameter that determines how efficiently a business is run and how effectively its management or owners are able to manage their resources [6]. Therefore, an important aspect is to accurately determine the profitability at different levels, which will identify the key strengths or weaknesses of the company's performance as soon as possible [7].

We believe that such key ratios include return on equity (ROE), return on assets (ROA) and return on sales (ROS).

The ROE is the relation of net income to equity. This ratio provides information about an entity's ability to generate a profit for every zloty generated from equity. ROE is a measure that informs about the degree of return on equity. The more the value of this indicator increases, the higher is the efficiency of the used equity capital and the better are the opportunities of the examined enterprise. In other words, ROE is an incentive for investors who expect to maximise dividends and increase the value of the unit.

The ROA ratio measures the ability of assets to generate profits in an entity. It is calculated as the relation of net income to total assets and thus tells how much profit is generated per unit of total assets. Since ROA indicates a more stable financial position of a company, it is believed that the higher its value, the better the situation of the company.

The ROS indicates the proportion of net income to sales, i.e. how much sales are needed to generate a specific amount of profit. The lower the value of the ROS ratio, the more sales are needed to generate the same amount of profit. Therefore, the higher the value of the ROS ratio, the higher the financial situation of the company must be assessed.

The choice of the aforementioned profitability indicators is not accidental. They are not only measures of the most relevant business parameters [8; 9]. They also allow us to draw additional conclusions as a result of comparing their values with each other. The economic content of each indicator makes it possible to argue that ROS affects both ROE and ROA. Higher ROS means higher net income relative to revenue, which can increase ROE. At the same time, higher ROS means better profitability of operations, which can be reflected in higher ROA. ROE and ROA are also related to each other: a higher ROE can increase ROA if the company effectively uses external capital through financial leverage.

Hence, it can be assumed that the profitability indicators considered can be combined with each other through inequality:

$$ROE > ROA > ROS \qquad (1)$$

The interpretation of inequality depends on the company's specific conditions, objectives and strategy.

Where a company is focused on maximising ROE, it may take actions such as using financial leverage or focusing on activities that increase net income relative to equity. In this case, ROE will be highest, while ROA and ROS may be lower.

A high ROE can also be achieved through efficient use of assets. If a company is able to generate significant added value from a relatively low asset base and at the same time has a moderate ROS, the mentioned inequality can be achieved.

Where companies can achieve high net income through complex operations or innovation, the inequality in question will also make sense.

Against this background, we can conclude that ROE, ROA and ROS ratios can be assessed not only by their own interpretation, but also by comparing each other, which increases their informative value for managers and external observers. At the same time, it is important to note that each of these ratios assesses different aspects of a company's financial activities. ROS focuses on operating profitability, ROE focuses on equity efficiency, and ROA focuses on asset utilisation.

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