

# THE FINANCIAL EQUILIBRIUM AND COMPETITIVENESS WITHIN AGRICULTURAL HOLDINGS

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*ABSTRACT: The paper refers to traditional methods of appreciating the financial equilibrium of the agricultural company, methods based on the study of the company's financial statements. As far as financial equilibrium is concerned, we consider that there's no specific indicator to be analyzed in order to appreciate financial equilibrium due to different perception the stakeholders have on the enterprise equilibrium. In real life we often see the same indicator calculated differently according to the objective pursued by the analyst. This paper shows the calculation method of the static financial equilibrium indicators, the evolution and the factors leading to the alteration of these indicators, their financial management. It also determines financial equilibrium by financing rates method and assesses financial equilibrium using profitability rates for agricultural holding companies. It concludes with the specific factors that affect the financial equilibrium in agricultural holdings.*

*Keywords: financial equilibrium, competitiveness, agricultural holdings, indicator*

*JEL Codes: G32, Q12*

According to the emergency ordinance no. 108/2001 concerning agricultural holdings, these are “*complex forms of organising the land which use land, livestock and other production means, interconnected in a unitary system, for an efficient result of agricultural products.*”

They are different from one another according to their legal organisation, type of property, the nature of the activity, economic size and dimension.

Agricultural holdings can be formed of one or more land properties, livestock and the necessary means of carrying out different farming activities.

According to their economic size and dimension, the agricultural holdings, organized according to the Ordinance no. 108, are classified into: commercial holdings, family holdings and mixed holdings.

A. It is necessary that *the commercial agricultural holdings* have certain dimensions, are specialized in plant or animal production and have a series of facilities from the state in order to improve the economic efficiency, production growth and the quality indexes of the farming products.

B. *The family agricultural holdings* are the holdings with dimensions within the limits mentioned in the art. 5 line (1) from the Ordinance no. 108, in which the land is used by a family, supplying the leading and execution work and the capital, in order to obtain agricultural products for a sufficient balanced diet for its members and to obtain incomes that could allow to secure some means necessary for the production process (fertilisers, herbicides, seeds, reproduction livestock) and to cover the family's needs.

C. *The mixed agricultural holdings* are the ones that already have arable lands and livestock of different species.

For them, through GD no. 734/2002 transformation coefficients are laid out in percentage shares of the agricultural lands and livestock, thus creating possibilities of respecting the dimensional criteria mentioned in no. 108/2001 (of minimum 100 points), being able to enter the

category of commercial mixed agricultural holdings.

Another classification of individual holdings, according to the time spent working, the structure of the activities, the income level and the degree of participating on the market, show that out of the about 4.24 million holdings, 13% are “part time”; 1% are “multi-active” holdings; 36% are autarchic village households, 40% subsistence households and only 10% are trading family farms.

According to the INS data for 2005, the 4.237.889 individual agricultural holdings have 99.5% of the total of agricultural holdings (4.256.152) and only 0.5% are holdings belonging to companies and legal entities. Out of the individual households, 2/3 (about 3.2 mil. including the autarchic ones from the first classification), are subsistence holdings, decreased rated capacity, producing mainly for consumption, slightly participate on the product market and have a decreased degree of economic viability. They can handle the market pressure under the circumstances in which they practise with a partial working time, combining the agricultural activity with other rural activities (extractive, handicraft, food, wood manufacturing, and tourism industry).

Individual households have almost 65.5% of the agricultural field of the country, which represents a very valuable source for national economy, which needs to be supported by the state in order to become the main supplier of farming products on the internal and external goods market, but which can ensure equal incomes for the agricultural producers as well.

*Agricultural units with an enterprise status* are organized according to the The Land Law no. 18/1991, the Law of Companies and Partnerships no. 31/1990 and the Law no. 15/1990 regarding the re-organisation of the state-owned companies into national agencies and trading companies. Therefore, they come from the former state agricultural enterprises, the state complex facilities for the breeding and fattening of swine and cattle, for poultry breeding complexes, the agriculture mechanization stations, research resorts, etc.

Table no. 1

*Agricultural units with an enterprise status*

The type of the enterprise	The enterprises	Characteristics
Authority Society <i>Or</i> National Agency	<ul style="list-style-type: none"> <li>• The National Society for Land Melioration</li> <li>• The National Authority for Ecological Products</li> <li>• The National Society for Agricultural Products</li> <li>• The Veterinarian National Authority</li> <li>• The National Agency for Improvement and Reproduction in Animal Husbandry</li> <li>• The National Society for Race Horses</li> </ul>	<p>Executes works of land melioration</p> <p>Guides and ensures the stocks in the ecological agriculture</p> <p>Contracts, deposits, delivers farming products, facilitates the access of the unit to credits, supplies seeds and fertilisers for them</p> <p>Guides and ensures the veterinarian actions</p> <p>Carries out services related to the activity of ensuring seminal and animal selection material</p> <p>Produces, breeds and sells different horse breeds</p>
Agricultural trading companies	Trading companies specialized on poultry, swine, cattle, sheep breeding, etc.	Grow and exploit the effectives, sell production. The cattle and the sheep breeding can also have a land for fodder.
	Mixed trading companies (plans and animal husbandry)	Own and exploit public land (state) and some people's land
	Agricultural mechanization trading company	Perform farming work for individual producers, associates
	Trading company for producing combined fodder	Buys cereals and other raw matters, produces and sells combined fodder
	The contracting and buying trading company COMCEREAL, CEREALCOM farming products	Carries out the same activities as the Farming Products National Agency
	SEMROM trading company (with county branches)	Produces and sells seeds for field crops
	UNISEM trading company (with county branches)	Produces and sells seeds and seeding material for gardening
Food industry	Food industry trading company	Buys, processes and sells products of plant and animal origin.

The financial equilibrium at the level of the enterprise, regardless of its object of activity, therefore at the level of the farming enterprise as well, represents that state of the value size in an enterprise characterized by a certain correspondence, reflected in a system of correlations:

- between the financial sources necessary for the carrying out of activity under normal circumstances in order to fulfil the objectives of the enterprise and the destination of financing the respective sources,
- between takings and payments, rights and obligations,
- between risk and profitableness.

The need and evaluation of the way of achieving the financial equilibrium, elaborating some insurance criteria, as well as all the debates on this subject, emphasize its importance in making decisions, both at an internal level – in getting, allocating and administering the resources, and at an external level, of the different investors – in the options of placing their availabilities.

The enterprise evolves in a dynamic environment, the opportunities and constraints of which continuously change, which implies an adequate answer from it, under the circumstances of maintaining a certain balance, adding that every development stage implies the alteration of the present balance favouring the future one, and that every present lack of balance must contain the premises of a new balance, situations that cannot be surpassed but by achieving a productive efficient profit generating activity.

The financial equilibrium represents a constituent of the economic balance, the estimation of which – at the level of the enterprise – depends on the objectives of the people who order or study such analyses.

Through the angle of the managers' interests in the firm, appreciating the financial equilibrium is connected to the objective of maximizing the value of the enterprise, to which we add financial flexibility, economic growth, financial autonomy and power criteria. Under these circumstances, the causes of the lack of equilibrium can consist either in the lack of financial flexibility or in the desire to postpone the financial autonomy or control or to maximize the economic growth. Thus, in a short time, we have to face the issue: if maintaining the financial autonomy and the control or obtaining of a maximum increase is compatible with reaching a satisfying level of profitability.

Through the shareholder's angle, it is considered that the financial equilibrium is respected if the profitability it is offered to it by such a placing compensates for the risk it is exposed to, a risk dependent on the economic factors that determine the profitability of the goods and on the debt politics practised by the enterprise. The symptoms of the lack of balance from the shareholders' point of view show up when they do not obtain the profitability of their own funds that they expect, taking into account the economic, financial and bankruptcy risk they are exposed to.

Appreciating the financial equilibrium through the angle of the bank creditors is related to their objective of getting the repayment of their rights and of getting back the deserved payment. The symptoms of the financial lack of equilibrium are expressed through the angle of the bankruptcy risk, culminating with the stopping of payments. An increase of the bankruptcy risk determines the creditors either to ask for instalment interest or to reconsider the given credit; the appearance of such situations in a company constitutes the unquestionable indicator of financial difficulties.

Other groups such as the salary earners, the State and the company have, of course, objectives related to the activity of the company: the ability of the company to pay salaries, to select the employees, to pay the taxes in time and the financial ability to fulfil certain social duties and to have a pleasant environment.

Taking into account the information presented above, we consider that the most adequate definition of the financial equilibrium would be as it follows:

Regarding the indicators of the financial equilibrium, we mention that there is not a certain indicator through the analysis of which the financial equilibrium could be appreciated; due to the different perception the ones who have an interest in the enterprise have on its equilibrium. In practice, we encounter many times the same indicator calculated differently according to the objective followed by the analyst of the given indicator, such as the abolition perspective and the one referring to continuing the activity.

The main short time and long time financial equilibriums of the enterprise are emphasized through the analysis of the accounting balance sheet by the correlations of some sizes, such as: the net situation, the production fund, the necessary for the production fund, the treasury.

Table no. 2

*The financial equilibrium indicators*

The name of the indicator	Symbol	The formula
The net situation	ANC	Total of assets – Total of debts*
		Own capitals = Social capital + capital bonuses + re-evaluation stores + stores +/- The reported result +/- the result of the exercise – the reassigning of the portfolio
		Real assets** – Total Debts
Gross or total production fund <sup>1</sup>	FRB	Total Capital (Tc) – Immobilised assets (Ig)
Net production fund <sup>2</sup>	FRN	Permanent capital (PmC) – Immobilised assets (Ig)
		Present assets <sup>3</sup> (Pg) – Short term debts <sup>4</sup> (STD)
Own production fund	FRP	Own capital (Oc) – Immobilised assets (Ig)
Borrowed or foreign production fund	FRS	FRN – FRP = (PmC – Ig) - (Oc - Ig) = PmC – Oc = Debts for more than a year
The necessary for the production fund	NFR	(Present goods – Short time financial investments – The house and bank accounts) – (Present debts – Sums owed to the credit institutions < 1year)
Net treasury	TN	FRN – NFR
		Short term financial investments + The house and bank accounts – Sums owed to credit institutions < 1year

\*The total of debts includes, along with the elements of duties towards the third parties, the following elements:

- the incomes registered in advance as they reflect the duties of the enterprise towards its clients, which need to be honoured in the coming period;
- the supplies that are included in debts in very clear situations, as it follows:
  - when the commissions have an aim and well stated values, there is a high probability of using them and not a simple way of spending them; the expense that covers the commissions is depicted before finalising the financial exercise period;
  - when the commissions are destined for covering the risks identified as inevitable for the activity of the enterprise;
- the grants for investments.

If the commissions do not meet the requirements in order to be included into debts, then they are included in the result of the exercise.

In the accounting of the countries with a market economy, where the enterprises assign their profits, after the approval of the result, by the general assembly of the subscribers, therefore, after more months since the end of the exercise, there is a difference that is made between the net situation and the one with own capitals, as it follows:

- own capitals are determined at the end of the exercise, before the result is affected;
- the net situation is calculated after the result is affected.

\*\* The real assets = assets – Fictitious assets

The fictitious assets are assets that are considered “non-values” as, in the case of sale, they cannot create cash fusion. These elements are registered in the balance sheet due to reasons related to the technique of accounting registering, even though they normally had to be registered in the result account. They are registered in the balance sheet so that it should not affect the result of the exercise in which the respective expenses were made, being followed either by paying them off for a longer period of time (immobilised fictitious assets), or assigning them in the following exercises (circulating

<sup>1</sup> The Order of the Minister of Finance no. 616 for the approval of the methodological Norms regarding the elaboration of the income and expenses budget by the economic agents, the Official Gazette of Romania no. 286/26.06.2000.

<sup>2</sup> According to the balance sheet settled by OMFP 1752/2005, the production fund appears on position E

<sup>3</sup> The present goods are formed of totally circulating goods and advance payments (the account 471)

<sup>4</sup> The short time debts are formed of debts lower than a year and advance incomes (the account 472)

fictitious assets).

Determining own capitals represents the main issue in the FRP calculation it refers to the net situation of the exercise after the result has been affected and it corresponds to the funds granted to the enterprise by its owners, with no limit or duration. Nevertheless, some analysts think that when it comes to determining their own production fund and their own capital, both the subvention investments<sup>5</sup> and the commissions should be included.

The grants for equipments can generally be considered permanent capitals. In the laws of some countries they are subjected to taxes, being included in the result account as incomes, by successive instalments. These subventions imply latent fiscal debts, the expiration of which will come in medium and long term.

Consequently, in the FRN calculation investment grants can be included, in permanent capitals and not in the personal ones. Unlike this, in the calculation of the personal production fund, in the personal capitals not only the part corresponding the latent reserves will be included, but also the part corresponding the fiscal debts must be excluded.

In its turn, including the commissions in own capitals seems to be justified, if establishing them allows them to consider they have an extra character. Nevertheless, the commissions that do not cover a real future risk, but present an extra character, need to subsequently suffer a tax. In the weight of the taxable benefit the commissions will be reintegrated, excessively constituted compared to the effective risks and they will be taxed. The enterprise will suffer a fiscal debt, but its expiration will be, in all cases, in a year.

Thus, we can consider that the commissions that do not strictly cover real and future risks and will not be consumed in short time – can be considered permanent capitals.

In practice, the size of the commissions needs to be correlated with the size of the risks. Thus, if the commissions are not enough and not all the risks are taken into account, we can get a much too optimistic estimation on the enterprise, which does not reflect the reality. On the other hand, if the size of the commissions is oversized compared to the risks of the enterprise, then a part of these commissions present an extra character and they can be considered permanent resources. Due to this, treating the whole of the commissions correctly needs adopting the following solution<sup>6</sup>:

- a first solution, often used, implies radically applying the principle of caution and appreciating the fact that the commissions cover real and future risks and are included in short time resources;

- a second solution, more satisfying than the first one, starts from the observation that most of the economic factories reconstitute from a year to another an increasing size of the commissions. This growth appears as a permanent source, even if its different components are short time preserved;

- a third solution is an intermediate one and implies arbitrary assignment of the financial resources in order to constitute the commissions. Thus, 40-50% of the financial resources are meant for constituting the commissions that present an extra character and are assimilated by the permanent resources. The difference will be used for constituting the commissions of covering the real and future risks, and the respective resources will be short time ones.

The connection between the production fund, the necessary for the production fund and the net treasury as financial equilibrium indicators led to classifying the enterprises in 6 cases.

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<sup>5</sup> I. Vasile, *The financial administration of the enterprise*, Didactică and Pedagogică Publishing House R.A, Bucharest, 1999, p.107

<sup>6</sup> I. Vasile, cit. works, p. 107

Table no. 3

***The situation an enterprise can have according to the relation between the financial equilibrium indicators***

Case	Balance indicators			Situation
1	FR +	NFR -	TN +	Short term equilibrium Long term equilibrium
2	FR +	NFR+	TN +	Long term equilibrium Short term equilibrium
3	FR +	NFR+	TN -	
4	FR -	NFR-	TN +	Long term lack of equilibrium Short term lack of equilibrium
5	FR -	NFR-	TN -	
6	FR -	NFR+	TN -	Long term lack of equilibrium Short term lack of equilibrium

We continue to present a simplified balance sheet of an agricultural exploitation based on which the financial equilibrium indicators will be calculated.

Table no. 4

***Balance sheet***

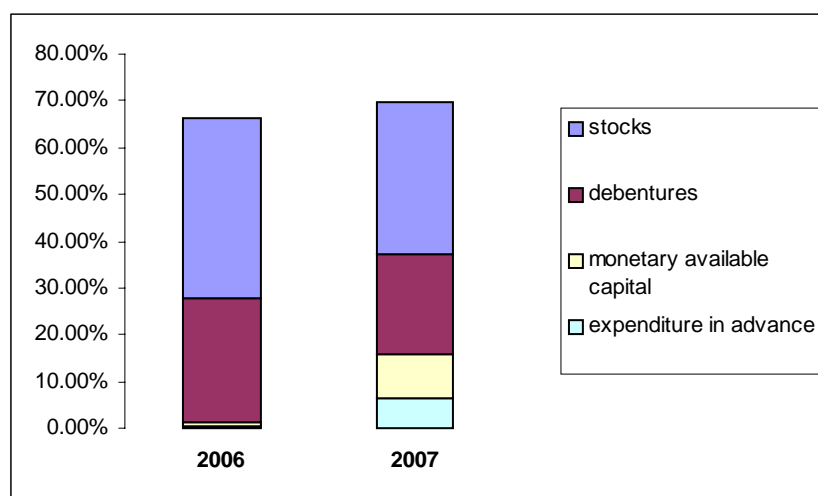
Assets = Net necessities (RON)	The financial exercise		Passives = Resources (RON)	The financial exercises	
	Previous	Current		Previous	Current
Permanent necessary	42.745.722	35.857.863	Permanent capitals	76.616.535	63.866.240
A. Net immobilised assets	42.745.722	35.857.863	Own capitals	54.934.059	47.898.421
I. Non-corporal immobilisations	265.286	145.524	Capitals and reserves	33.455.017	18.768.922
II. Corporal immobilisations	42.466.441	35.698.344	I. Capital	8.480.300	8.480.300
III. Financial immobilisations	13.995	13.995	II. Capital bonuses	0	0
Temporary necessary	99.319.721	70.512.073	III. Re-evaluation reserves	2.420.065	2.455.949
B. Circulating assets, out of which	99.319.721	70.512.073	IV. Reserves - total	22.554.652	7.832.673
I. Stocks	46.188.928	40.756.320	V. The reported result - Sold C	13.960.907	14.960.907
II. Rights	30.833.811	28.605.078	VI The result of the exercise (unassigned)	7.518.135	14.168.592
III. Short term financial investments	0	0	G. Debts for a period >1 year	9.245.070	8.757.948
IV. The house and bank accounts	13.433.709	920.657	H. Commissions	0	0
C. Advance expenses	8.863.273	230.018	I. 1. Grants for investments	12.437.406	7.209.871
			Temporary resources	65.448.907	42.503.696
			D. Debts for a period <1 year	61.329.498	42.490.682
			I. 2. Incomes registered in advance	4.119.409	13.014
Total of net assets	142.065.443	106.369.936	Total of capitals	142065442	106369936

The financial equilibrium indicators resulted after the calculations are presented in table 5.

*The financial equilibrium indicators of the agricultural holding*

Indicator	The financial exercise		The deviation $\Delta \pm$
	Previous	Current	
ANC	47.898.421	54.934.059	7.035.638
FRB	70.512.073	99.319.720	28.807.647
FRN	28.008.377	33.870.813	5.862.436
FRP	12.040.558	12.188.337	147.779
FRS	15.967.819	21.682.476	5.714.657
NFR	46.592.121	53.188.490	147.779
TN	-18.583.744	-19.317.677	-733.933

The net situation of the trading company was positive; it grew with 7035638 RON due to the faster increase of the assets than the increase of debts, which reflects a healthy economic administration that maximizes the value of the enterprise. Most of own capitals were the consequence of a superior growth, compared to the reductions registered in all the constituent elements of these capitals.



*Fig. no 1. - The evolution and the structure of the total or raw production fund*

The raw production fund increased based on the monetary availabilities and the advance expenses.

Regarding the net production fund, the necessary for the production fund and the net treasury, the analysed company is included in the third category presented in table 1.

Even if the company is in long-term equilibrium, it is confronted with an unfavourable gap between liquidating the stocks and the rights and the exigibility of the exploitation debts, slowing the takings and accelerating the payments, the result being a negative treasury. Even if the situation shows a certain limiting of the financial independence, this cannot be interpreted as a state with no solutions at all. The trading company would have to act so as to recover the rights, to hasten the rotation speed of the stocks and probably to re-launch the expiration of the temporary resources, which will lead to diminishing the necessary of producing fund and the treasury deficit. In case the normal activity of the exploitation circle allows the justification to try the financing in a certain



proportion of the circulating assets based on short-term bank credits, the financial ability to pay of the company does not seem to be considered through a negative treasury. This situation is confirmed by reality with the help of financial statistics, which show that in most of the economic sectors, the companies present statements of negative treasuries, this circumstance not influencing their financial state.

The politics adopted by the managers of the analysed company is a defensive one and it wants to achieve some high business figure with stocks and lifted liquidities. For any increase of the business figure, the managers are interested in the corresponding increase of the stocks, which ensure the continuity of the exploitation activity (current and safety stocks). Financing the financial needs of the company is done especially from permanent resources (the production fund), ensuring the solutions for the enterprise, but it implies a superior cost of the resources compared to the one of the short term bank credits, but also a covering of the renewing of the credits and the increase of the debt instalment; in other words, even if the politics is expensive and less profitable, it is more careful.

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