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PERFORMANCE EVALUATION OF REAL SECTOR IN SERBIA*

Ocena performansi realnog sektora
u Republici Srbiji

Abstract

Financial performance failure in Republic of Serbia real economy sector started at the very beginning of nineties in the last century. At that time, this sector started to go behind in competing with numerous other countries, whose economies were, just year or two earlier, in many aspects below our achievements. Even greater disaster is that real sector competitiveness continued to diminish dramatically during the first years of transition and that trend has not been stopped even after conclusion of ownership transformation in it. In the meantime, our economy did not manage to avoid big economic crisis whose implications in this region were revealed even more dramatically, having in mind that entire Republic of Serbia economy had already been overwhelmed by crisis during the previous decades and that in the last few years there have not been any significant movements in providing healthy business environment. The aim of this paper is to, with carefully chosen set of indicators, make research of causes and consequences of real sector competitiveness decrease in Republic of Serbia. Within our paper two aspects of this issue will be particularly investigated. First, our attention will be directed to the research of the present situation and trends of real sector financial-structural position, with special emphasis on analysis of liquidity, indebtedness, as well as assets and equity management efficiency. And secondly, our research will include analysis of profitability status and movements, as well as long-term financial stability position of real sector. Both these aspects of the research will serve us as ground for comprehending present situation, identifying causes, recognizing development path and removing financial imbalance, in order to provide necessary assumptions for recovery and strengthening of real sector competitiveness in the following period.

Key words: *competitiveness, real sector, performance measuring, liquidity, indebtedness, solvency, efficiency, profitability.*

Sažetak

Posrnuće finansijskih performansi realnog sektora privrede RS otpočelo je još na samom startu 90-tih godina prethodnog veka. Naime, već tada ovaj sektor počinje da zaostaje u nadmetanju sa mnogim drugim zemljama čije su privrede do samo pre godinu ili dve bile u mnogo čemu ispod ovdašnjih ostvarenja. Da nevolja bude veća, konkurentnost realnog sektora nastavlja da drastično opada sa prvim godinama tranzicije i taj trend nije zaustavljen ni posle okončanja vlasničke transformacije unutar ovog sektora. U međuvremenu našu privredu nije zaobišla velika ekonomska kriza čije su se posledice na ovom području još drastičnije ispoljile imajući u vidu da se celokupna privreda RS već nalazila u višedecenijskoj krizi i da godinama unazad nije bilo nekih značajnih pomaka u obezbeđivanju zdravog privrednog ambijenta.

Ovaj rad ima za cilj da pomoću pažljivo odabranog seta indikatora istraži uzroke i finansijske posledice pada konkurentnosti realnog sektora u RS u proteklom periodu. Unutar toga posebno će biti istražena dva aspekta ovog problema. Prvo, naša pažnja biće posvećena istraživanju stanja i kretanja finansijsko-strukturnog položaja realnog sektora sa posebnim osvrtom na analizu položaja likvidnosti, zaduženosti i efikasnosti upravljanja imovinom i kapitalom. I, drugo, naše istraživanje obuhvatiće analizu stanja i kretanja profitabilnosti i dugoročne finansijske stabilnosti realnog sektora. Oba navedena aspekta istraživanja treba da nam posluže kao osnova za sagledavanje trenutnog stanja, dijagnostifikovanje uzroka, prepoznavanje puteva razvoja i otklanjanja finansijske neravnoteže kako bi se obezbedile potrebne pretpostavke za ozdravljenje i jačanje konkurentnosti realnog sektora u narednom periodu.

Ključne reči: *konkurentnost, realni sektor, merenje performansi, likvidnost, zaduženost, solventnost, efikasnost i profitabilnost.*

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Introduction

Serbian economy faced global financial and economic crisis completely unprepared to cope with problems following this crisis. Exhausted by wars, economic sanctions and longtime passivity in transition process, economic activity has, to put it mildly, stagnated in the last four years. Problems regarding economic activity decrease, general illiquidity, growth of indebtedness, technical and technological outdatedness and increasing investment risk have deepened further.

Longtime negligence of real sector in favour of financial sector was not sustainable on long terms. Chronic lack of capital in the real sector was useful to financiers who, dictating crediting terms, suffocated further the companies already in troubles. Additional financial expenses deepened financial imbalance of companies operating in real sector. On the other hand, financial sector directed its activity towards safer and more profitable transactions on financial market, neglecting the needs of real sector regarding reasonable financing terms. We might say that there is an unnatural dichotomy of financial and real sector.

Creating the strategy of increasing real sector competitiveness is not possible without current state evaluation. Understanding the existing performances should indicate the seriousness of the issue and point us to the causes of financial disturbances. That could be a sound ground for identifying potential directions towards existing-performance improvement. Finally, by providing the overview of real-sector performance state, we will create the conditions for understanding the effects of adopted strategy regarding real sector competitiveness improvement.

For the purpose of this paper, we confined ourselves to key sectors dealing with manufacturing goods and generating value added. Without intention to confine the real sector only to the industries to be included in this analysis, we decided, to this paper's ends, to include the following industries in the real sector, according to the official classification: agriculture, forestry and fishing, mining, processing industry, construction and supply of electricity, gas and steam. These sectors have included, on average, 28,000 companies and have employed a little less

than 600,000 employees. This, of course, does not mean that some other sectors like telecommunications, transport and so on, are less important. For now, we will adjourn their analysis. The choice of such a limited real sector is caused by the opinion that structural disorders are the most serious in it. Furthermore, without the efficiency of these sectors, we undoubtedly cannot talk about national-economy sustainable development.

Performance analysis is based on financial statements of companies belonging to the real sector.¹ Financial statements refer to a five-year period (2006-2010). However, we will reveal some results only for the last four years, as some of the indicators and statements can be calculated only for this period. In this paper, we will present abridged and a little different structural statements compared to their official form. By this we mean balance sheet and income statement, while we intend to create on our own the other reports in this paper, like statement of cash flow and statement of net working capital. Based on this information and with the comprehension of liquidity, solvency, efficiency and profitability analysis, we will try to evaluate real sector performances.

Analysis framework

The basic aim of the following article is to research real-sector financial performance movement in the sequence of four business years, from 2007 to 2010. The basic reason to choose this period comes from our intention to use 2007 as the destination year for performance evaluation, having in mind that this was the business year in which the usual business activity of our economy was manifested. The following three years include the period when consequences of big economic crisis were manifested with varying intensity in domestic economy performances. We recognised a professional challenge in measuring and analysing the movement of real-sector financial performances of this period and we are determined to approach it hereinafter.

In order to present better the part of economy that we named „real sector“ for the purpose of this article, in

¹ Source: Agency for Business Registers of the Republic of Serbia

Table 1 we give some information that at first seemed the most interesting to us.² As you may notice, two types of data are given in this Table. First, those are absolute data regarding the movement in number of companies and employees, operating assets value, net capital, cumulated losses and total liabilities for real sector as a whole. Secondly, those are data regarding relative share of some industries in total real-sector achievements. Accordingly, the displayed Table provides (before we start a deeper analysis) comprehension of real-sector complexity as well as of relative position of some industries in it.

So, based on displayed information one can see that in each year the focus of our attention will be about 28,000 companies grouped into five industries that we chose considering the fact that most of goods are produced

in them, i.e. they generate most of material values. As you may notice, most of analysed companies belong to processing industry (over 60%), then come construction and agriculture, while the number of companies belonging to mining and energetics is considerably smaller. Within this context we can state that total number of companies belonging to real sector increased until 2010 when it dropped. Hence our interest to investigate hereinafter the source of this decrease, whether it may be the consequences of crisis or something else.

The next data that we pay attention to is the number of employees. At the level of real sector in the analysed period, the decrease of employment was by over 25%, or 105,000 employees, while this data was generated from the fact that almost 47,000 employees a year lost their jobs from 2008 to 2010. This point itself is very important and we hope that the following research will reveal real

² All financial data in this article are given in 000 dinars.

Table 1: Real sector structure

	Agriculture	Mining	Processing industry	Supply of electricity	Construction	Real sector
Participation in number of companies						
2007	14.30	0.98	63.35	0.54	20.83	26,924
2008	13.66	1.01	62.32	0.61	22.39	28,176
2009	13.02	1.09	62.33	0.83	22.73	29,025
2010	12.04	1.09	60.66	1.10	25.13	28,548
Participation in number of employees						
2007	8.43	6.80	65.02	4.95	14.80	605,408
2008	7.87	6.91	64.39	5.07	15.76	593,318
2009	7.78	7.26	63.60	5.45	15.91	546,900
2010	7.77	6.89	63.31	5.98	16.06	500,364
Participation in operating assets						
2007	10.33	8.17	47.38	18.43	15.69	3,586,980,636
2008	10.35	7.62	48.65	16.82	16.56	4,063,938,396
2009	10.36	6.64	49.94	16.53	16.54	4,237,677,587
2010	8.67	6.32	44.46	22.09	18.46	5,079,010,357
Participation in net capital						
2007	12.21	9.33	35.33	30.51	12.62	1,639,051,367
2008	12.57	7.86	36.88	29.25	13.45	1,663,982,793
2009	12.94	4.33	38.29	30.32	14.12	1,613,050,750
2010	10.25	4.61	31.30	40.35	13.50	1,864,714,507
Participation in cumulated losses						
2007	5.69	9.20	54.49	24.40	6.22	723,370,997
2008	6.36	9.85	53.66	23.52	6.61	850,150,374
2009	7.70	13.15	54.06	17.90	7.19	989,916,414
2010	6.52	10.93	52.24	20.38	9.93	1,174,571,625
Participation in total liabilities						
2007	8.90	7.11	58.36	7.08	18.55	1,900,409,314
2008	9.01	7.35	57.04	7.40	19.20	2,320,200,518
2009	8.86	8.02	57.47	7.33	18.31	2,561,091,886
2010	7.82	7.29	52.26	10.98	21.65	3,149,804,079

causes that brought to this, by many criteria, worrying decrease of employment. Considering the distribution of employees by industries, it is very much similar to previously mentioned distribution. Instead of repeating this information, it is more useful to stress that almost 80% of employees in real sector is recruited to do the jobs in processing industry and construction, while the rest of them are equally distributed among agriculture, mining and energetics.

If we, for a change, focus on the next set of displayed information that are financial, we may notice that relations among the industries considerably change. So, speaking of operating assets, it is most present in processing industry, then in energetics, construction and agriculture, while the

smallest investments in operating assets are in mining. In the analysed period, total investments in real-sector operating assets increased by more than 42% and the following research will show if this result is satisfactory. Investments in operating assets referring to companies of mining industry decreased steadily, relatively speaking, while the share of energetics and construction increased. Analysed individually, the greatest relative decrease of investments in operating assets is present in processing industry and in the last year in sequence.

Concerning net capital of the real sector, it increased by only 35% in the analysed period. If perceived by selected industries, the situation is very similar to the distribution above mentioned regarding the share in total

Table 2: Abridged balance sheet

	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
A. Fixed Assets	1,936,578,716	2,237,761,727	2,454,690,211	2,521,157,579	3,043,091,089
I Subscribed capital unpaid	10,509,967	9,435,506	39,126,125	25,845,276	26,097,443
II Goodwill	827,533	929,719	1,481,739	1,587,146	2,284,974
III Intangible assets	26,662,952	33,267,371	55,213,976	51,843,598	72,484,983
IV Property, plant and equipment	1,713,818,952	2,002,695,626	2,152,872,924	2,202,920,600	2,365,654,442
V Long-term investments	184,759,312	191,433,505	205,995,447	238,960,959	576,569,247
B. Current assets	1,172,069,662	1,346,908,611	1,598,610,100	1,704,639,048	2,017,428,332
I Inventories	433,994,533	520,241,037	601,226,718	602,373,604	709,009,343
II Account receivables	566,175,223	602,079,771	737,318,747	771,596,607	914,644,028
III Short-term investments	64,350,524	87,189,507	105,115,382	138,927,214	163,599,394
IV Cash and cash equivalents	67,701,146	87,072,218	81,574,605	103,160,077	113,251,778
C. Value Added Tax and Accruals	33,209,335	41,678,489	73,374,648	88,581,546	116,923,789
D. Deferred tax assets	7,633,922	10,957,887	10,638,085	11,880,960	18,490,936
E. Total assets	3,109,643,399	3,586,980,636	4,063,938,396	4,237,677,587	5,079,010,357
F. Loss over capital	167,145,050	190,446,177	231,499,782	304,744,018	381,922,846
G. Total assets and loss over capital	3,276,788,449	3,777,426,813	4,295,438,178	4,542,421,605	5,460,933,203

	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
A. Capital	1,558,252,730	1,838,933,050	1,934,608,700	1,943,640,044	2,272,734,796
I Nominal paid in capital	1,455,185,284	1,489,349,750	1,558,372,480	1,569,577,636	1,933,590,745
II Subscribed capital unpaid	10,509,967	9,435,506	39,126,125	25,845,276	26,097,443
III Reserves	58,890,706	65,225,250	66,499,165	67,601,229	68,949,872
IV Revaluation reserves	127,472,840	409,922,125	448,154,522	467,692,649	472,169,006
V Unrealized gains on securities	0	0	3,294,515	4,895,313	3,387,376
VI Unrealized losses on securities	0	0	3,959,929	6,777,340	5,236,788
VII Retained earnings	308,716,823	398,870,399	444,160,331	504,289,030	569,935,558
VIII Loss	401,604,645	532,924,820	618,650,592	685,172,396	792,648,779
X Stock repurchases	918,245	945,160	2,387,917	4,311,353	3,509,637
B. Long-term provisions	19,552,247	23,767,400	36,989,560	50,692,378	58,946,574
C. Long-term liabilities	486,709,121	521,974,454	630,843,540	748,761,821	953,183,862
D. Short-term financial liabilities	252,873,120	322,438,523	462,133,752	495,381,494	646,719,827
E. Current operating liabilities	900,770,799	989,555,569	1,072,897,600	1,124,562,801	1,320,630,373
F. Accrual and deferred income	40,332,264	43,030,387	117,336,066	141,693,392	170,323,443
G. Deferred tax liabilities	18,298,168	37,727,430	40,628,960	37,689,675	38,394,328
H. Total capital and liabilities	3,276,788,449	3,777,426,813	4,295,438,178	4,542,421,605	5,460,933,203

operating assets. Namely, most of capital is concentrated in processing industry, then in energetics, construction and agriculture, while mining has the smallest share in total net capital of the sector. Comparing shares of all the industries in 2010, the greatest improvement is seen in energetics whose share in total net capital of the sector increased by 10% in that year.

Since in income statements of the companies belonging to the above mentioned economic sectors we can see that losses prevail, it is interesting to look into the distribution of force here. First, we should notice that total losses of the real sector from 2007 to 2010 doubled, forecasting more serious troubles. Further on, more than 50% of total losses of the sector were generated by processing industry in all these years. Energetics has its share of more than 20% in these losses, with some fluctuations, then come mining with the average share of more than 10%, while losses are almost equally distributed between agriculture and construction, being at about 6%.

We left total liabilities for the end of the analysis. At the level of this sector, they increased by almost 1.7 times in the analysed years, which tells us about emphasized tendency of indebtedness. Such a conclusion worries us since we have not forgotten that net capital value increased by only 35%. Nevertheless, only thorough financial analysis ahead of us will show to what extent it really endangers real-sector business operations. Here we can add that, of all the selected industries, processing industry decides on borrowing most often, absorbing between 58-52%

of total borrowed capital. Considerably smaller relative indebtedness is seen in companies belonging to other industries. Among them, construction stands out, with the share in total borrowed capital threatening to exceed 22% in the next period.

So, it is obvious that in this research we deal with very heterogeneous companies. However, regardless of previously analysed and many other differences evidently present among the selected industries and their companies, for the purpose of this paper it was necessary to give them all a common denominator. We estimated that choosing the value principle is probably the best solution. Hence we first provided financial statements for each sector, coming from basic financial statements of analysed companies, and only then did we approach to workout of total financial statements of the real sector. In order to use more efficiently the approved space for this article, we continue to give you abridged balance sheets and income statements of the real sector, which will serve as ground for the following analysis (see Tables 2 and 3).

Considering the good practice of financial statement analysis, in the next part of the paper we decided to cover three aspects of the analysis:

- analysis of short-term financial risks,
- analysis of long-term financial risks and
- analysis of profitability.

Now, let us analyse more thoroughly the position of real sector in our economy regarding all previously mentioned parameters.

Table 3: Abridged income statement

Positions	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
A. Operating revenues and expenses					
I Operating revenues	2,105,883,787	2,420,046,896	2,715,610,522	2,466,775,279	2,968,840,894
II Operating expenses	2,072,713,956	2,370,135,681	2,644,668,859	2,404,790,635	2,832,424,307
III Operating income (loss)	33,096,379	49,622,049	70,901,558	61,927,485	136,269,841
B. Financial revenues and expenses					
I Financial revenues	100,665,887	78,201,727	106,554,650	84,923,928	110,571,360
II Financial expenses	98,638,221	107,099,889	218,731,891	192,309,556	268,791,014
III Net financial revenues (expenses)	2,027,666	(28,898,162)	(112,177,241)	(107,385,628)	(158,219,654)
C. Net other gains and expenses	3,561,248	(77,808,263)	12,385,187	(59,104,463)	(30,673,463)
D. Income (loss) before taxes	38,685,293	(57,084,376)	(28,890,496)	(104,562,606)	(52,623,276)
E. Income taxes	4,140,213	(3,991,297)	7,856,545	3,459,656	2,300,072
G. Net income (loss) after taxes	34,545,080	(53,093,079)	(36,747,041)	(108,022,262)	(54,923,348)
EBITDA	236,561,615	188,689,632	342,559,792	243,564,988	366,712,733
EBIT	137,323,514	50,015,513	189,841,395	87,746,950	216,167,738

Analysis of short-term financial risks

analysis and evaluation of real-sector financial position in our economy supposes that we first understand its liquidity, i.e. short-term financial risks. This segment of financial analysis is very often identified as the analysis of short-term risks, which will be our viewpoint as well in this paper. Overall understanding of this phenomenon supposes the use of ratio analysis, particularly indicators of liquidity and turnover, as well as the analysis of net working capital (hereinafter NWC) and the analysis of cash flow synchronicity, particularly inflow and outflow of cash coming from operating activities. This is the reason why in Table 4 we first give comparative achievements of liquidity ratio, turnover ratio and duration of cash cycle.

If we first focus on values of liquidity ratio, we may instantly state that our real sector cannot brag about any acceptable achievements. Namely, if we compare values from Table 4 with landmarks present in business practice of developed countries for many years, we may conclude that liquidity of our economy's real sector seriously goes behind. To be more precise, noted values of current ratio and quick ratio in the analysed period are really uniform, yet they are practically halved compared to what every expert analyst would like to see. Having in mind that the account of static liquidity ratio is based on ratio between current assets and its parts on one hand, and current (short-term) liabilities on the other hand, displayed values reveal the decrease in efficiency of current-assets management and cumulating current liabilities.

We find the confirmation of previous standpoint in the review of average number days of inventory in stock and accounts receivable turnover. If, for the moment, we relate this to the fact that payables turnover shows even

more dramatic tendency of accelerated decrease and that the average period from generating to settling liabilities to suppliers is 224 days at the end of the analysed period (note: that number was "only" 145 days in 2007), we can conclude, even at this point, how this group of companies shifts the burden of cash cycle financing, followed by greatest part of illiquidity burden, to the back of their suppliers. Starting from the hypothesis that considerable number of suppliers will act rationally, as well as that in such circumstances they will not be able to cover their cash cycle with short-term liabilities, the illiquidity problem in our economy gets a spiral form, i.e. it shifts from companies to suppliers, and then from suppliers to their suppliers and so on endlessly.

Along with this story, one should notice that in the analysed period the relations among certain parts of assets and real-sector financing sources change dramatically and in a very bad direction. To confirm this, we state negative NWC values increasing from less than 6 billion RSD in 2007 to remarkable 101.7 billion RSD at the end of 2010.³ Perhaps it sounds more convincing if we say that negative NWC in the analysed period increased by remarkable 17.5 times. Within that, the part of NWC owed to its own sources is negative as well, and it decreases steadily. However, due to more than scarce investments in fixed assets (they increased by more than 35% in four years), own NWC is still in gradual decrease compared to total NWC, i.e. it decreased „only“ twice. At the same time, presented Statement of Net Working Capital reveals us that long-term liabilities increased year by year, where only liabilities based on long-term loans increased by almost 100% in the analysed period (see Table 6). We cannot but state that long-term liabilities of the sector increased

3 Further information is contained in the next part of the paper (see Table 6)

Table 4: Indicators of liquidity and cash cycle

Indicators	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Current Ratio	1.00	0.97	0.97	0.95
Quick Ratio	0.60	0.60	0.63	0.61
Cash Flow from Operations Ratio	(0.02)	(0.04)	0.00	(0.03)
Average No. Days Inventory in Stock	80	86	103	96
Average No. Days Receivables Outstanding	90	92	113	105
Average No. Days Payables Outstanding	145	216	210	224
Cash Cycles	25	(39)	6	(23)

especially in the last two years of the period. For example, only in 2010, it increased by more than 200 billions RSD.

Nevertheless, despite its intense, long-term indebtedness, during this period real sector did not manage to provide any part of its inventories which burdened the state of its liquidity further. To be more precise, along with the problem of inventory turnover and their conversion into cash, the gap between NWC and the amount of inventories increased continually. Namely, deficiency of NWC increased by more than 1.6 times from 2007 to 2010 and it had to be compensated with deferring liability payment to suppliers and intense short-term borrowing from banks which increased by more than twice in this period. The greatest shock of short-term indebtedness for the real sector came in 2008 and 2010, whereby indebtedness at these grounds increased by almost 150 billion RSD a year. Finally, maybe the most appropriate notice to tell about the pace of short-term indebtedness is that, in the last analysed year, accumulated current operating liabilities make more than 70% of net capital. If we add short-term financial liabilities to current operating liabilities in 2010, we will be stunned by the fact that their total is higher than the value of net ownership capital!

As usual, the final part of liquidity analysis is left for understanding the level of cash flow synchronicity, primarily of cash inflow and outflow, coming from

operating activities (see Table 5). Knowing that, generally speaking, this part of cash flow statement should generate cash surplus in order to sustain long-term liquidity (and it is the case here since our analysis includes 4 business years in sequence), displayed results regarding our real sector are considerably worrying. This is because, with the exception of 2009, in other years the group of analysed companies created negative net cash flow from operations (CFO). In the last analysed year, it reached the value beyond 66 billion RSD, which is doubled compared to the beginning of analysed period. Due to all this, one should not be surprised with rather low values of current liabilities coverage ratio appearing from CFO and those values were shown previously in Table 4. Just these few notices related to cash flow leave a very bad impression concerning liquidity and ability of real sector to take the burden of current indebtedness, not to speak of future one.

In order to have a better insight into the state of real sector liquidity, we need to analyse more thoroughly the structure of inflow and outflow of cash from operations. Regarding this, we could look into several facts important to draw a final conclusion. First of all, cash flow from income statement was negative in the second half of the analysed period, where particularly low value was shown in 2009 when the strike of economic crisis was strongest and the analysed companies obviously could not

Table 5: Statements of cash flows

Positions	31/12/2007	31/12/2008	31/12/2009	31/12/2010
I Cash flow from operating activities				
1. Inflow from Income Statement	142,889,272	165,940,557	169,520,856	158,799,191
2. Outflow from Income Statement	(131,294,806)	(143,301,691)	(192,946,190)	(165,494,708)
3. Cash flow from income statement	11,594,466	22,638,866	(23,425,334)	(6,695,517)
4. Increase working capital	91,765,047	175,170,155	80,419,471	224,697,623
5. Decrease in working capital	(134,226,325)	(265,123,459)	(56,271,463)	(284,635,379)
6. Cash flow for changes in working capital	(42,461,278)	(89,953,304)	24,148,008	(59,937,756)
7. Cash flow from operations	(30,866,812)	(67,314,438)	722,674	(66,633,273)
II Cash flow from investing activities				
1. Inflow from investing activities	78,201,727	106,554,650	84,923,928	110,571,360
2. Outflow from investing activities	(463,770,574)	(357,882,137)	(269,378,087)	(696,898,518)
3. Cash flow from investing	(385,568,847)	(251,327,487)	(184,454,159)	(586,327,158)
III Cash flow from financing activities				
1. Inflow from financing activities	590,454,948	445,326,375	352,763,129	849,215,280
2. Outflow from financing activities	(154,648,217)	(132,182,063)	(147,446,172)	(186,163,148)
3. Cash flow from financing	435,806,731	313,144,312	205,316,957	663,052,132
IV Net cash flow	19,371,072	(5,497,613)	21,585,472	10,091,701
V Cash - beginning of year	67,701,146	87,072,218	81,574,605	103,160,077
VI Cash - end of year	87,072,218	81,574,605	103,160,077	113,251,778

find appropriate answers. Within this part of cash flow statement, it is interesting to notice that cash flow from income statement was poor through the whole period. Having in mind that real sector generated losses in all analysed years, it becomes clear that majority of inflow arises from depreciation and amortization charges.

However, from evaluation point of view regarding the liquidity of real sector, what is even more concerning is negative cash flow arising on grounds of changes in current assets and liabilities. It is mostly owed to increasing investments in inventories which reach their customers harder and harder, as well as to financing accumulated accounts receivable which are hard to charge, usually with a delay. We may notice that not all the achievements in 2009 share the same destiny and that they are shown in minimum net inflow of cash on these grounds. However, if we grasp a little deeper into this achievement, we can see that there is no reason to be happy with it. This is because in 2009 there was a considerable accumulation of operating liabilities which brought to short-term recovery of net cash flow and to new problems regarding sustainability of liquidity in future as well. The sector did not have to wait long to see these problems arising. Namely, at the end of 2010, net cash flow based on changes in current assets and liabilities was turned from net inflow of 24 billions, reported at the end of 2009, into net outflow of almost 60 billion RSD.

All the issues previously discussed bring us to a final conclusion that companies belonging to the real sector of our economy have really big problems related

to maintaining short-term financial risks, and none the less serious are the problems of financing from internal sources, servicing liabilities to related creditors and, finally, attracting new investments and return payment to owners. Of course, what arises from all this is high and growing short-term and long-term risk, as well as completely legitimate reluctance of investors in terms of starting some serious capital investments in this region.

Analysis of long-term financial risks

Some of previous conclusions have already traced the path in which our real sector moves regarding solvency, i.e. long-term financial risks. Nevertheless, apart from the fact that we have, during the liquidity analysis, already detected problems regarding the deficiency of positive CFO, slowdown in turnover of current assets and its parts, the collapse of financial structure by means of greater indebtedness and cumulating negative NWC, at this point, we would like to add a few more details to the picture of long-term risks of investment in the real sector of our economy.

Speaking of volume and structure of the assets determining the position of long-term financial stability, we can state that investment in operating assets rose by over 42% in the analysed period. Here, it is particularly important to point out that investments in current assets grow considerably faster compared to investments in fixed assets, which, in normal circumstances, should not be known to real-sector companies that were intensely supplied with

Table 6: Statement of net working capital

Postions	31/12/2007	31/12/2008	31/12/2009	31/12/2010
1. Capital	2,362,422,364	2,514,133,167	2,602,967,164	3,039,286,132
2. Cumulated losses	723,370,997	850,150,374	989,916,414	1,174,571,625
3. Net capital (1-2)	1,639,051,367	1,663,982,793	1,613,050,750	1,864,714,507
4. Fixed assets	2,228,326,221	2,415,564,086	2,495,312,303	3,016,993,646
5. Own net working capital (3-4)	(589,274,854)	(751,581,293)	(882,261,553)	(1,152,279,139)
6. Long-term provisions and liabilities	583,469,284	708,462,060	837,143,874	1,050,524,764
7. Net Working Capital - NWC (5+6)	(5,805,570)	(43,119,233)	(45,117,679)	(101,754,375)
8. Inventories and similar current assets	572,877,413	685,239,451	702,836,110	844,424,068
9. Excess (deficiency) NWC (7-8)	(578,682,983)	(728,358,684)	(747,953,789)	(946,178,443)
10. Short-term financial liabilities	322,438,523	462,133,752	495,381,494	646,719,827
11. Excess (deficiency) NWC a (9+10)	(256,244,460)	(266,224,932)	(252,572,295)	(299,458,616)
12. Own NWC / Inventories	(102.86)	(109.68)	(125.53)	(136.46)
13. NWC / Inventories	(1.01)	(6.29)	(6.42)	(12.05)
14. NWC / Current assets	(0.43)	(2.68)	(2.63)	(5.00)

fixed assets due to nature of their operating activities. We previously stated that total investments in fixed assets in the analysed period increased by a little more than 35%, which can be considered an unsatisfactory result in this four-year period. This statement becomes even more obvious if we turn our attention to changes happening within fixed assets. So, it is easy to see that, in this period, average investments in intangible assets, property, plants and equipment (with respect to depreciation charges) decreased, year by year, by more than 100 billion RSD. To be more precise, they fell from the initial 435 billions to only 203 billion RSD in 2009. What is encouraging is that these investments finally increased at the end of 2010, i.e. they were at 330 billion RSD at the time. However, having in mind these achievements and knowing that investments in manufacturing and sales facilities are reflected through the investment in property, plants and equipment, any other comment in terms of potential strengthening of real sector solvency makes no sense at this point. Since we have already said something about the increase of investments in current assets and its parts, as well as of ways of financing these investments, there is no need to raise this question again.

The value and structure of financing sources, i.e. relation between capital and liabilities, is the next factor directly determining long-term financial risks. In this case, we can notice the tendency of decreasing the share of ownership capital in total financing sources which could be one more relevant signal related to assurance of long-term creditors. Considering all cumulated losses, we

can conclude that the share of net capital in total capital and liabilities is under 50% in the analysed period, i.e. it fell from the initial 43% to only 34% at the end of the analysed period. In order to complete the picture of relative amount of capital disposable to our real sector, let us for a moment go back to initial claims of Statement of Net Working Capital. We can see that cumulated losses in each year decreased capital by more than one third, where this decrease was most convincing at the end of 2010 when total loss „ate“ almost 39% of ownership capital. Due to all this, net value of ownership capital in all these years was not enough to cover long-term, i.e. risky investments in fixed assets, which is one of crucial indicators speaking in favour of compromised long-term risks of our real sector.

In order not to make a confusion, let us point out here that in previous abridged balance sheet of the real sector we presented, at the assets' side, the position of loss over the value of capital, to emphasize that, within this sector, there is a number of companies to have lost their entire capital. It is interesting to notice that the amount of loss overcoming the amount of ownership capital was doubled in the analysed period. By emphasizing these asset losses, we only stressed previous statements regarding absolute and relative decrease of capital where many long-term creditors have traditionally seen an „air bag“ for their claims.

As it usually happens in cases like this, the decrease of ownership capital is followed by the increase of total real sector indebtedness and the indicators shown in first part of Table 7 speak in favour of that. Namely, during the

Table 7: Indicators of solvency and efficiency

Indicators	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Fixed Assets Coverage Ratio	0.74	0.69	0.65	0.62
Fixed Assets and Inventories Coverage Ratio	0.78	0.75	0.75	0.75
Own NWC / Inventories	(102.86)	(109.68)	(125.53)	(136.46)
NWC / Inventories	(1.01)	(6.29)	(6.42)	(12.05)
NWC / Current assets	(0.43)	(2.68)	(2.63)	(5.00)
Debt to Equity	1.18	1.42	1.61	1.71
Cash Flow from Operating to Debt	(0.02)	(0.03)	0.00	(0.02)
Cash Flow from Operations / Interest Expenses	(0.52)	0.53	(0.67)	0.40
Interest Coverage Ratio	(0.29)	(0.31)	0.00	(0.25)
Assets Turnover	0.71	0.70	0.59	0.63
Operating Assets Turnover	0.66	0.65	0.54	0.56
Capital Turnover	1.58	1.62	1.50	1.69
Quality of Revenues	0.99	0.95	0.99	0.95
Capital Expenditure Ratio	(7.11)	(20.72)	0.36	(19.95)

whole period, indebtedness increased steadily, where it is important to point out that short-term indebtedness is far more often. At the same time, the burden of interest becomes practically unbearable to the sector. It is reported through the fact that interest costs in the analysed period almost tripled on average, while at the same time the sector did not manage to cover those costs, neither by means of realised earnings, i.e. earnings before interest and taxes (EBIT), nor by released CFO. Practically, in all these circumstances, our real sector cannot count on any RSD generated from internal sources during the payback of accumulated debts. All this speaks enough of how serious the position of real-sector long-term financial risks really is.

Along with deterioration of asset structure, losses of capital and growth of indebtedness and based on second part of indicators shown in Table 7, we can state that in the analysed period our real sector reported very low values of the ratio of assets turnover, operating assets turnover and current assets turnover on one hand, and capital on the other hand. As it usually happens in cases like this, inadequate assets and capital management affected directly the revenue capacity of the real sector. Namely, after the insight into comparative review of income statement for the analysed period, we can conclude that operating revenues at the end of 2010 increased by a little more than 22% compared to 2007. Having in mind that operating revenues usually reflect operating activity, we can state that reported growth is far below the necessary achievements (results). The greatest fall of operating revenues happened in 2009, when they practically dropped to the level of 2007. To tell the truth, operating revenues at the end of 2010 reported growth by about 20% compared to the year before, which is hardly 10% growth compared to 2008, so, based on that, we cannot conclude that real-sector operating activity was finally increasing. Fortunate in this story is that cash inflow did not go behind reported operating revenues and as a proof of this we have very low values of revenue quality ratio in all analysed years.

Finally, at this point we could stress that growth of real sector indebtedness in the whole period was followed by the decrease in efficiency of assets and capital management. It makes the position of real sector even

more difficult when it comes to long-term financial risks. This is because the real sector of our economy cannot use the turnover as leverage effect and multiply the influence of growth in revenue capacity of assets and capital on its profitability. Nevertheless, since turnover is only one of profitability leverages, we will leave for the end of this paper the analysis of other factors' influence on this most important factor of long-term financial stability, hoping that they will change the situation up to certain extent.

Profitability analysis

It is often said that profitability is the final test for the success of a company, branch, sector or economy as a whole. There are two possible reasons for that. The first one owes to the fact that profitability is directly related to achieving owners' interests and it is one of the key factors encouraging or discouraging investors to invest again. Other important reason for profitability's high ranking in total performance evaluation comes from the fact that profitability is inevitable determinant of liquidity, long-term stability and sustainable growth.

On previous pages, we stressed serious disorders in financial structure, which, among others, reflect in the decrease of ownership capital, cumulation of losses and increase of indebtedness level and which are strengthened by serious problems regarding profitability of companies and branches belonging to real sector, which is the subject of our analysis. Having this in mind, we will first try to present general picture of real sector profitability, by means of some standard indicators, and then we will make an effort to identify the causes of such position. To realise the first goal, we will rely on globally used profitability tests: Return on Equity (ROE), Return on Assets (ROA) and Return on Operating Asset (ROOA). Their values are decomposed to appropriate profit margins and turnover ratios, given in Table 8 for the analysed period of four years.

Generally speaking, profitability analysis demands the answer to two questions. The first one is related to presence of capacity to generate return on capital belonging to owners, while the other one refers to the profitability of core business, i.e. capacity to generate return on total used assets, regardless of the way that company was financed.

Thereby, meeting ownership expectations is tested with ROE, while ROA and ROOA are used as tests for core-business success. Linking ROA and ROE is extremely important, because excess return on total assets over cost of debt (fixed return of capital lenders) overflows to owners' return.

The seriousness of profitability problem, or in other words, unprofitability, is apparent at first sight. Cumulative analysis of all industries included in real sector for the purpose of this paper implies that in each analysed year ROE was negative and ROA was just slightly over zero. Though it has been popular these days to attribute all negative effects to the economic crisis, it seems that financial, structural and profitability disorders have surpassed time frame since the beginning of crisis. Of course, we do not scrutinize negative effects of crisis, but results show that situation was not much better even before the crisis. This only confirms that structural disorders, low level of activity, inefficiency and outdatedness in technical and technological development have had longer history.

Return on assets, measured by the ratio between EBIT (Earnings Before Interest and Tax) and average total assets, has, particularly due to EBIT growth, its greatest values in 2008 (4.42) and in 2010 (4.09). Appreciating EBIT as the rate of ability to pay debts, we conclude that these values are unsatisfactory. Namely, generated values are far from costs of debt. Such negative effects overflow to ROE, turning them into negative values in all analysed years. Negative influence of financial leverage is obvious, and there is no need to analyse it further.

Differences between ROA and ROOA occur as the consequence of content incompatibility of gains in

numerator and assets in denominator. Since the concept of operating assets is more narrow than the concept of total assets for the value of long-term and short-term investments, higher ROOA could be expected. However, a wider concept of incomes taken in calculating EBIT compared to operating income, caused the decrease in operating income due to higher EBIT. This only reconfirms profitability problems.

To all above mentioned, we should add that returns were calculated on net values of investment basis. It means that we decreased capital for the amount of cumulated losses and that we did not add losses to total assets. Facing with reality in that way, we presented returns as more favourable than they really are.

These circumstances demand deeper analysis that should provide better understanding of unprofitability causes regarding the analysed sector. In order to do so, we turn our attention to the analysis of result structure, result dispersion by individual sectors within real sector and ROA, calculated by the ratio between EBITDA (Earnings Before Interest, Tax, Deprecation and Amortization)⁴ and total assets.

The analysis of result structure includes the analysis of operating income and net financial revenues (expenses), the analysis of net income structure and the ratio between EBIT and financial expenses. Thereby, our main goal is

⁴ In Serbian business and accounting practice, it is acceptable to use the name EBITA instead of EBITDA. EBITA concept corresponds to a concept widely known as EBITDA, since in both cases amortization (depreciation) charges of intangible assets, property, plants and equipment, are added to EBIT. However, since EBITDA is globally recognised measure and there is a possibility to think that depreciation charges regarding property, plants and equipment are excluded, we decided to keep the name EBITDA.

Table 8: The review of key profitability indicators

Indicators:	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Operating Income Margin	2.08	2.65	2.52	4.63
Operating Assets Turnover	0.78	0.76	0.65	0.72
Return on Operating Assets - ROOA	1.61	2.02	1.64	3.35
EBIT Margin	1.65	6.27	2.79	6.43
Assets Turnover	0.71	0.70	0.59	0.63
Return on Assets - ROA	1.18	4.42	1.66	4.09
Profit Margin	(2.22)	(1.37)	(4.40)	(1.87)
Capital Turnover	1.58	1.62	1.50	1.69
Return on Equity - ROE	(3.52)	(2.23)	(6.59)	(3.16)

Note: Profit margins are calculated based on operating revenues without correction of inventory values

to locate the key areas of real sector unprofitability. The results of performed research are given in Figures 1, 2 and 3. At this point, we leave aside other, not so small others gains and losses, since they potentially have a transitory character.

In operating income statement, a part where achievements of core business are measured, the real sector as a whole operates positively. However, revealed net operating incomes are really poor annually, which is also confirmed by earlier operating income margins not exceeding 2.65% in the first three years. Only in the last analysed year, operating income margin equals poor 4.63% again.

On the other hand, in financing income statements, a part which includes financial transactions (revenues and expenses based on interest, exchange rate effects, etc.), it

is apparent that in each analysed year financial revenues go behind financial expenses. Thereby, in the last three analysed years, financial expenses are more than doubled compared to financial revenues, with the inconvenient ratio tending to grow. What is most important to notice here is that losses from financial transactions, except in 2007, exceed operating incomes steadily. In this way, inappropriate borrowing, along with inconvenient effects of exchange rate effects, turn operating incomes into net losses, which generates great balance-sheet suspicion through cumulating losses and consequent capital decrease. This process is enforced by net losses based on other incomes and expenses (except in 2008 when there is a net income). From this point of view, exposure of the analysed real sector to long-term risks is huge.

Figure 1: The analysis of operating income

Figure 2: The analysis of net financial revenues (expenses)

Figure 3: The analysis of income structure

In normal circumstances, financial expenses should not exceed EBIT. In this case, financial expenses constantly exceed EBIT, even by 2.8 times in 2009. It only confirms that real sector at this activity level cannot take such burden of financial expenses.

We could say that real sector as a whole and as a capital intensive sector is in a vicious circle. Emphasized dependency on high investments in fixed assets and follow-up long-term risks also imply a great share of top-quality (own) financing sources. This requires internal financing sources, i.e. profit which would be partly retained for the purpose of internal financing. As there is no profit and obtaining capital from new issues becomes harder, turning towards external creditors is inevitable. Since they are extremely expensive, they increase losses further, creating more serious financial troubles.

The lack of internal financing sources disables launching serious investment projects, without further collapse of financial structure. Previously provided cash flow analysis, as well as capital-expenses coverage ratio given in Table 7, imply this. We could see there that

capital investments, except symbolically in 2009, were not financed from internal sources. External financing appeared as inevitable. The decrease of ownership capital and the increase of debt implies turning toward borrowed financing sources. Thorough analysis, that we cannot present here due to a limited space, shows that short-term financial liabilities take considerable share in such financing. Sustainable growth is not possible in such circumstances.

With all the worrying facts previously mentioned, we should have in mind that we deal with the analysis of a large unit, consisting of five selected sectors. Each of these sectors contains numerous branches and companies. That implies being careful at drawing conclusions for, at least, two reasons. First, revealed net incomes in balance sheets from the beginning of the paper were calculated from the difference between net incomes and net losses. It shows, that, within real sector, there are vital parts as well, i.e. healthy companies that can do business successfully. Favorable business environment, real instead of declarative investors' assurance, developed and

Table 9: The review regarding participation of certain income components in real-sector achievements

	Agriculture	Mining	Processing industry	Supply of electricity	Construction	Real sector
Participation in operating revenues						
2007	7.70	12.48	56.33	9.01	14.48	2,420,046,896
2008	8.04	8.47	58.43	9.64	15.41	2,715,610,522
2009	8.29	7.21	58.28	11.39	14.83	2,466,775,279
2010	8.14	8.06	56.00	14.37	13.44	2,968,840,894
Average	7.91	10.11	56.96	10.70	14.33	2,535,431,476
Participation in operating expenses						
2007.	7.85	12.67	55.76	9.84	13.88	2,370,135,681
2008	8.20	8.65	58.02	10.50	14.62	2,644,668,859
2009	8.58	7.54	58.07	11.50	14.31	2,404,790,635
2010	8.42	7.42	56.45	14.66	13.05	2,832,424,307
Average	8.14	10.12	56.85	11.09	13.80	2,464,946,688
Participation in financial expenses						
2007	7.13	9.86	64.98	3.50	14.53	107,099,889
2008	5.36	11.15	63.18	6.03	14.28	218,731,891
2009	7.02	10.95	61.79	4.76	15.49	192,309,556
2010	5.50	10.47	54.41	9.11	20.51	268,791,014
Average	6.37	11.01	61.13	6.07	15.41	177,114,114
Participation in EBITDA						
2007	8.64	12.24	79.18	(25.33)	25.28	188,689,632
2008	3.83	7.61	60.00	9.69	18.87	342,559,792
2009	2.59	(1.29)	61.02	14.80	22.89	243,564,988
2010	2.60	15.06	50.17	14.48	17.69	366,712,733
Average	4.36	9.41	59.96	6.60	19.67	275,617,752

transparent capital market and cheaper financing sources could be the indispensable stimulus for the growth of real sector. Disciplined payment of due claims is assumed as well, which excludes tolerance of the opposite behaviour (where some public or other companies take the lead). The problem is that such companies lead some vital parts of the sector into illiquidity.

Secondly, revealed cumulative results are not equally grouped by individual sectors. No doubt that financial troubles are everywhere, but it is also obvious that they burden in different ways the performances of real sector as a whole. Accordingly, to get a general image of the influence of individual sector performances on total real sector performances, we present the review regarding participation of certain income components by years, as well as figure regarding average participation of these components in the real sector (see Table 9 and Figure 4).

Without the ability to provide deeper analysis, due to a limited space, and convinced that provided reviews are enough themselves, we have just a few notices. It is obvious that processing industry has a dominant influence on real sector performances, its share being about 50% or more almost everywhere. This sector also takes the greatest burden of financial expenses, over 60% on average. In spite of that, the greatest share of EBITDA is shown in this sector, in the same cumulative value. Construction also gives considerable contribution to real

sector achievements, where results measured by EBITDA are the second largest. Finally, we should not forget that depreciation and amortization charges are excluded from EBITDA, so this indicator can be understood in that context as well.

Eventually, in order to identify further the causes of inappropriate achievements and find solutions for overcoming current state, let us turn to ROA for EBITDA, which has the highest values of all returns. It is the return which is, besides being released from the influence of financial sources, also released from the amortization of fixed assets to be written-off. It is the fact that amortization is the expense that requires no cash outflow. Due to emphasized capital intensity, these expenses are often very high. Due to their high level, they (reasonably) decrease profit. Again, the fact that amortization does not require outflow immediately makes company functioning much easier. ROA for EBITDA, decomposed to profit margin and turnover ratio, is given in Figure 5.

Though calculated values of ROA for EBITDA are higher than any return so far analysed, we must say that these values are far from impressive. This is true, especially if we have in mind how many expenses are left outside EBITDA concept. However, at this point the idea is to grasp deeper into the causes of real sector unprofitability, by means of this indicator, free from financial leverage and the influence of various amortization policies. By

Figure 4: The analysis of result structure in real sector

decomposing ROA for EBITDA to profit margin and assets turnover, we realise that total assets turnover is below 1 and that it is lower in the last two analysed years compared to the first two years. Obviously, nominal growth of 41.6% in total assets in this four-year period is not followed by estimated growth of operating incomes that rose by 22.7% in 2010 compared to 2007. Thorough analysis reveals even more dramatically the problems in this field. Namely, in four years, inventories rose by 1.3 times, receivables by 1.5 times, short-term investments by 1.9 times and long-term investments by 3 times. At the same time, the growth of investments in intangible assets, property, plants and equipment, is smaller in 2010 compared to 2009 than in 2007 compared to 2006.

We could draw two conclusions from the above mentioned. First, investments in fixed capacities stagnate. Since these are investments that should bring return in future, it is reasonable why the income growth goes behind the assets growth. Above-average investments in inventories and receivables are more the reflection of problems in manufacturing and sales, as well as in account receivables payment, than the result of sector activity growth. Secondly, low and receding turnover ratios do not seem to be the consequence of assets growth. Done investments are not enough. Low turnover ratios are primarily the consequence of inefficient revenue growth. Again, it points us towards two possibilities. Existing assets, due to its ageing, cannot generate appropriate

revenues, or capacities are not used enough. We believe this is for both reasons.

More than necessary rise of economic activity level would improve turnover ratios, but it would reflect positively on profit margin increase as well. Since there are variable as well as fixed expenses within total expenses included in EBITDA calculation, it would be real to expect that potential growth of revenues would, due to degression of fixed expenses, be followed by accelerated growth of EBITDA, which would increase ROA for EBITDA through the increase of profit margin for EBITDA. If we add possible rationalizing at expenses'side, we believe that certain space could be created when it comes to increased ability to cover huge financial expenses in the first place.

Conclusion

The imperative of raising the level of competitiveness in Serbian economy real sector must rely on evaluation of existing performances. This is inevitable, at least for two reasons. First, the evaluation of present state is ground for understanding causes of financial imbalance and unsatisfactory profitability, due to easier and safer identification of courses of action. Secondly, it is important to make the overview of the current situation in order to set the benchmark for comparing the effects of created policies, which would help to increase responsibility of economic policy designers.

Figure 5: The analysis of ROA for EBITDA

Performed analysis of liquidity, which is ground for the evaluation of short-term financial risks, solvency analysis, as the ground for long-term financial stability, and profitability analysis, as the ground for the evaluation of investment attractiveness and sustainable growth potential, provide comprehension of current situation in our real sector. Concerning this, we provide some key conclusions.

First, the analysis of profitability and financial position revealed very high level of deformity in financial structure and unsatisfactory profitability. Such state is definitely a consequence of external factor activity which could not be controlled, as well as of internal inefficiency which should have been raised to higher level along with the process of privatization. Apparent financial disorders at global level create serious obstacles and challenges in the process of creating preconditions for the improvement of real sector performances.

Secondly, the state of liquidity, or, to be precise, illiquidity, is alarming. In 2010, average number days payables outstanding reached on average 224 days or 7.5 months at real sector level. Since this is average, it implies that there are some companies credited by suppliers for more than a year. Payment inability is spirally transferred from customers to suppliers, who become customers for their suppliers and so on. The problem is even more complex due to irresponsibility of public companies which, abusing their close relationship with state and political structures, often ignore deadlines regarding payment of liabilities. Concerning this, we could say that as long as this ignoring is tolerated, there will be no improvement in this field. It is clear that bad, insolvent companies will take some vital parts of the real sector into illiquidity.

Third, cash flow analysis confirms the implications of bad financial structure on payment ability. CFO structure, relevant for the evaluation of payment ability, reveals that high amortization, as the expense not requiring immediate cash outflow, along with high liabilities to suppliers (their participation in net capital is over 70%) and high short-term indebtedness (short-term liabilities exceed the amount of net capital), represent maneuvering space delaying final financial collapse of many companies. This, of course,

is sustainable on short terms. On long terms, damages arising from illiquidity could be devastating.

Fourth, the state of illiquidity is even more dramatic if we consider financial and structural disorders. NWC, as generally accepted measure of financial equilibrium, was negative in all analysed years. We should not forget that real sector has considerable inventories that should be, to great extent, financed on long terms. So, if we start from the fact that the level of NWC determines good or bad assumptions for maintaining liquidity, we can only conclude that there are no good assumptions in that sense.

Fifth, cumulating losses, present in each year, caused severe disorders of financial structure at real sector level. In 2010, the sector was burdened with losses and lost about 39% of capital value. This estranges companies from possibility to cover fixed assets, as the most risky investments, from own, top-quality sources. Within this context, about 60% of fixed assets is financed from own capital, and the rest is financed from long-term and short-term debts.

Sixth, cumulating losses also affects capital structure. The share of capital decreased to about 37%, and the share of borrowed sources increased. So, indebtedness increased. Thereby, total borrowed sources are almost equally distributed between interest liabilities (long-term and short-term financial liabilities) and non-interest liabilities. Furthermore, we should not forget that, having left losses over capital in assets, we wanted to send a message that the number of overindebted companies is not negligible.

Seventh, real sector as a whole operates with losses in all analysed years. It results in negative ROE and very low ROA. Since these returns are far from cost of debt, negative residue overflows to owners. Investment attractiveness is very low in these circumstances, which is also reflected in unsuccessful issues of new shares.

Eighth, causes of real sector unprofitability are numerous and they come from operating and financial activities. At this level of activity, the main reason for losses are burdening financial expenses. Inappropriate indebtedness, along with negative effects of exchange rate, turns already small operating incomes into net losses, thereby creating great financial troubles. Situation

becomes even more complex with the increase of need for additional capital. Since there are no incomes and the inflow of ownership capital is poor and inefficient, it leads companies to indebtedness, and, as a rule, they do this under unfavourable conditions.

Nineth, to all this we should add unfavourable efficiency within core business as well as low level of capacity use which prevents total expenses coverage. Even if we assume that effects of financial transactions are neutral concerning the net result, such achievements are not satisfactory. It is known that investors want higher returns compared to capital lenders since they take the highest risks. Necessary growth of economic activity must be followed by further investments in fixed capacities in order to overcome technical and technological outdatedness up to a point. We need assets able to create respectable incomes. Exit from

such situation should be seen in business and financial restructuring of companies, releasing balance sheet from losses, their assumption and taking to the burden of capital and finding strategic partners for capital increase in order to remove financial disorders.

Tenth, we should have in mind the limitations of this analysis before we draw final conclusions. Namely, this analysis is based on cumulative balance sheets. Net losses of the sector were calculated by clearing total incomes and total losses. It means that there are vital parts within the real sector, i.e. vital companies that can do business successfully. Support of these companies implies creating favorable business environment, providing real instead of declarative investor assurance, building high-quality and stable regulations, presence of developed and transparent capital market, as well as of cheaper financing sources.

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