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Original scientific paper

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POSSIBILITIES FOR IMPROVEMENT OF PROFITABILITY OF ENTERPRISES IN TOURISM INDUSTRY IN THE REPUBLIC OF MACEDONIA

Abstract

This paper treats issues related to profitability of enterprises in tourism industry in the Republic of Macedonia. The aim is to calculate financial ratios for assessment of profitability level in tourism industry and to analyze them.

Profitability is very important in determining the success or failure of a business for enterprises at whole, as well as for the enterprises in tourism industry. Higher values of profitability ratios indicates that operation of the enterprise is more efficient. It is obvious that profitability depends on many factors as: size of the enterprise, experience in the business, it's debts, leverage level, working capital utilization, inventory etc. The trend of these factors can serve as a guideline for planning of the increased workload or additional capital investment.

Financial analyze from theoretical and practical aspect identifies many indicators for measurement of enterprise profitability. In that context, for the aim of this paper key ratios of profitability are estimated for enterprises in Macedonian tourism industry.

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Introduction

Number of indicators used in financial analysis of enterprises are different depending on enterprises orientation and also it depends on the analyst purposes, the methodology applied, the type of industry that enterprise belongs to and etc. For that purpose, data from intra-statements and official financial statements of enterprises are used.

That means that in enterprises tourism industry, also record all activities and transactions in financial statements, which are then used in decision-making of different parts as: managers, owners, government, banks and other financial institutions, business partners, competitors and other stakeholders. Thus the profitability indicators are also used for the same purpose and it seems to be a significant determinant of an enterprise's credit risk. This is very important question in periods of luck of own capital and funds for doing business, when enterprises are forced to borrow from external financial sources.

However, there are evident shortcomings in making business decisions in tourism industry based solely on the financial analysis. Major weaknesses are related to: the use of only historical data, overlooked market value of assets in the balance sheet, high level of use of figurative accounting, neglect of important economic information on micro and macro level and the like. So, different aspect should be taken into account, weather we analyze all financial indicators, or we are focused on profitability level, as an important one

1. IMPORTANCE OF PROFITABILITY FOR ENTERPRISES IN TOURISM INDUSTRY

Success of tourism enterprises is a result of a complex investigation of external environment for market needs and opportunities from one side and from the creation and development of certain advantages of the enterprise from other side. Consequently, success is connected to specific resources that are unique for the enterprise and difficult to be imitated by other enterprises.

Such measurable characteristics include financial resources (own funds, borrowed funds), natural resources (size of the enterprise, capitalization) and intangible resources (human capital and innovation, which are approximated by the educational level of the personnel, and commercial resources such as trademarks, reputation etc. which are approximated by advertising expenses and export activities). (Agiomirgianakis et al. 2013)

Profit is especially important because it is necessary for the survival of a business. Low profitability contributes to under-capitalization problems because it leads to fewer dollars as retained earnings and therefore to a reliance on external capital. The ultimate goal of every investment is not solely the revenue grow or cost savings, but the generation of healthy returns, and that is what we call profitability. Profit margin is one of the main financial benchmark indicators between companies. Profitability is also usually the ultimate goal of any company (Žager, Mamić Sačer, & Dečman, 2012).

2. DEFINING AND MEASURING PROFITABILITY

One of the most difficult attributes of a firm to conceptualize and measure is profitability (Ross et al. 2007) . In a general sense, accounting profits are the difference between revenues and costs. However, the problem with accounting-based measures of profitability is that they ignore risk. In the economic sense, a firm is profitable only if its profitability is greater than investors can achieve independently in the capital market. In their text,) suggest some methods to measure profitability including profit margin or return on sales, return on assets, and return on equity.

- Profit margins are computed by dividing profits by total operating revenue and thus express profits as a percentage of total operating revenue.
- Return on assets is the ratio of income to average total assets, both before tax and after tax, and measures managerial performance.
- Return on equity is defined as net income divided by average stockholders' equity, and shows profit available for stockholders.

Business profit ratio shows the gross margin, ie how much of operating profit is generated by 100 units operating income. Net profit rate is a result remaining after covering all expenses of the enterprise, income tax, etc., or it shows the share of net profit in operating revenues. The meaning of this indicator comes to the fore if the results are compared with competing businesses in the same industry and is commonly used in practice.

ROA shows the profitability of total assets, ie the degree of growth of total operating assets involved in the enterprise. In fact, this indicator refers to the net profit and if it realizes unit engaged assets. Through this indicator data horizontal or trend analysis can be carried, or data might be compared with overall results of the tourism industry, group of enterprises or separate competitive enterprise.

Operating income ratio can be divided, it it is already known that than ROA can be increased by increasing the operating income through higher sale prices, declining of number of employees etc, as well as by faster turnover of total assets over a shorter turnover of inventories and faster collection of receivables. The point is to put attention on management of turnover of total assets in tourism enterprises.

Closely related to ROA is ROE and it is showing the level of return on equity while taking into account the financial structure that shows the growth of equity at the end of the period compared to the beginning. The results of this indicator can be improved by better level of net income and faster turnover of capital.

Table 1: Key profitability ratios

Ratio	**Measurement or computation**
Business profit ratio	*Operating income/total expences*
Net profit rate	*(Net income/sales) x (Sales/assets) x (Assets/equity)*
ROA (Return on assets)	*Net profit after tax/ total assets*
ROE (Return on equity)	*(Net profit margin) x (Total asset turnover) x (Leverage)*

It has to be considered that of the ratios summarized in table 1, four ratios: business profit rate and net profit rate, return on assets and return on equity are the most frequently used as the measurement of profitability of enterprises in whole, as in tourism industry, also.

3. FACTORS INFLUENCING PROFITABILITY OF ENTERPRISES IN TOURISM INDUSTRY

The main factors influencing profitability include revenue, costs and capital (Westerfield and Jaffe 1999) and (Cohen 1989). Recent literature analyzes the profitability of companies from various countries and economy sectors through indicators like net operating profitability (NOP) (Raheman et al., 2010), (Dong and Su., 2010), return on total assets (ROTA) (Deloof, 2003), (Padachi, 2006), return on invested capital (ROIC), return on assets (ROA) (Narware, 2010). In these cases, the elements considered by profitability analysis as independent variables are financial indicators that express the working capital.

Profitability at microeconomic level has been studied depending also on indicators such as current ratio, liquid ratio, receivables turnover ratio and working capital to total asset (Singh and Pandey, 2008). Other studies consider performance assessment expressed by earnings before interests and taxes (EBIT) and the associated risk resulted from the influence of using a certain financing structure (Akintoye, 2008) or expressing it though economic value added (EVA), return on equity (ROE), operating profit margin (OPM), earnings per share etc (Ryan, 2008).

According to consulted literature generally, many factors influence tourism enterprise profitability. Regarding the direction of the impact of specific determinants of profitability, theories are ambiguous about the how the size of firms actually affects profitability. According to many empirical studies at the international level, the average cost of small-sized firms exceeds the corresponding cost of large sized firms. Large firms may take advantage of economies of scale in their activities and this may well result in lower profitability of smaller firms (Barbosa and Louri, 2005). On the other hand, according to the Shumpeterian theory of creative destruction, small firms (especially in new technology fields) are usually the new entrants to the markets, gradually growing and acquiring market share and profits from the incumbent larger firms (Papadogonas, 2007). Therefore, although most researchers coincide that firm size impacts on firms performance, no clear consensus exists about the direction of this impact; however, based on the specific characteristics of the tourism industry where economies of scale appear to be present, it can be expectied a positive impact.

However, from the viewpoint of financial management, there is very important role in financial analyze of so called DuPont analysis. DuPont analysis is considered a standard model to analyze the factors affecting on enterprise profitability as well as the profitability of tourism industry enterprises. According to Eisemann (1997), a virtue of DuPont analysis is its simplicity. Three fundamental ratios derive one summary ratio: return on equity (ROE). Their relationships are as follows:

Return on equity = (Net profit margin) x (Total asset turnover) x (Leverage)
Net income/equity = (Net income/sales) x (Sales/assets) x (Assets/equity)

The ratios that determine ROE reflect three major performance dimensions of interest to all loan analysts: management of income statement, or how much profit a company can generate per 1 unit sales; and two aspects of management of balance sheet, that is how well assets can generate sales and the amount of solvency risk. The ratios also indicate that there are several paths that a business can use to gain a return for its owners: margin, volume, and leverage. While DuPont analysis technically only includes the three above mentioned ratios, the scope might be extended to incorporate most major financial ratios. It helps to think of the ratios as analogous to parts of a tree. The trunk is ROE and there are three major branches: profit margin, total asset turnover, and assets to equity.

From the equation of ROE, it appears that as leverage increases, ROE will increase too. The problem is that another effect of an increase in leverage is larger interest expense, which, causes a decrease in the profit margin and ROE. Thus leverage spreads its effects over two ratios, making it hard to disentangle the impact of leverage and operations. Moreover, profit margin is not really an accurate measure of operations, since it combines operations with financial leverage. To overcome this problem, the number of ratios is broken-down into smaller groups while permitting a more complete separation of operations and financial leverage. That is shown in the following equation:

Net income/equity = (operating income/sales) x (EBT/operating income)x (Net income/EBT) x (sales/assets) x (assets/equity)

This equation provides aproach into profit margin and leverage. The first of the three new ratios, operating margin, relates operating income to sales. Because operating income is before deduction for interest, this ratio calculate the underlying profitability of the enterprise and, except for the impact of leasing, is independent of how the firm is financed. The second ratio earnings before taxes divided by operating income. This ratio shows the income statement effect of financial leverage. As financial leverage and interest expense increase, this ratio decreases. To see this, consider a situation where there is no interest expenses or non-operating income. Earnings before taxes and operating income would be identical and the value of the ratio would be one. The last new ratio is net income divided by earnings before taxes. This measures the effect of taxes and is actually equivalent to one minus the effective tax rate.

4. EMPIRICAL RESULTS FOR PROFITABILITY RATIOS OF ENTERPRISES IN TOURISM INDUSTRY IN THE REPUBLIC OF MACEDONIA

Generally, profitability as a principle for achieving maximum profit with less used assets, can be shown through analyzing the following indicators: indicator of business profit and net profit rate- as partial indicators, as well as through ROA (return on assets) and ROE (return of equity) indicators- as a synthetic one. Special system of analyzing the profitability of enterprises is through the Du Pont analysis system, where by disaggregating ROA and ROE on separate components, management is trying to perceive appropriate strategies for improving profitability of tourism enterprise.

Despite the theoretical approach for determining the profitability level of enterprises in tourism industry, for the purpose of this paper quantitative research is conducted, too. Data that are further analyzed in the paper are derived through research conducted by questionnaire in period 2014/ 2015. The questionnaire was sent to 32 enterprises in tourism industry in the Republic of Macedonia, of which 25 enterprises have provided the answers to the questionnaire .

In Table 2 is shown an overview of the results obtained from the calculation of theoretical displayed indicators of surveyed enterprises for a period of 5 years.

Table 2: Profitability ratios of enterprises in tourism industry in the Republic of Macedonia

Profitability ratios in tourism industry	2011	2012	2013	2014	2015
Business profit ratio	14,53%	9,17%	16,56%	16,5%	16,58%
Net profit rate	14,31%	9,62%	15,98%	15,95%	15,99%
ROA (Return on assets)	2,16%	3,64%	6,52%	6,5%	6,55%
ROE (Return on equity)	2,16%	3,92%	6,49%	6,47%	6,49%

Source: Calculated ratios based on data in financial statements for appropriate years of surveyed enterprises in tourism industry

According to data in table 2 it can be considered, that observed tourism enterprises don't have significant level of indebtedness for the analyzed period of 5 years. As it can be seen business profit ratio and net profit rate data show that the highest level is generated in period 2013-2015, and the same conclusion for that period can be made for ROA and ROE indicator in tourism industry in the Republic of Macedonia. Final conclusions for the profitability level of enterprises in tourism industry in the Republic of Macedonia can be made if all financial indicators, as liquidity indicators for the same period at first, are taken into account. Otherwise, in spite of good results of profitability indicators it might be not in an optimal frame. This means that the profitability of enterprises is very complicated and problematic issue.

Separately, in almost all above indicators for profitability of tourism industry it is evident improved substantially, over the last three years of the analyzed period. However, positive influence on this data has the process of gradually overcoming the economic crisis world while and on European continent. Consequently, indirect impact of economic crisis on Macedonian economy is lower. Also, the situation is a result of good policy making in recent period and measures that are undertaken toward special affirmation of tourism on international level.

Conclusion

The essence of financial analysis of profitability of enterprises consists of using the results obtained by calculating the indicators of balance sheet items and their comparison with the standard, theoretical and empirical sizes. Conclusions from the analysis process are useful for internal and external, current and potential stakeholders in decision-making process in tourism enterprises.

That approach gives more reliable picture for the enterprise profitability level. That means that it's possible to have more accurate amount of revenue and operating expenses of the enterprise as a whole and in parts, ie monitoring of profitability trends by units, which is very important element for successful doing business in enterprises of tourism industry.

In order successfully to manage businesses and to be profitable in tourism industry, it is essentially important according to the stated criteria periodically to compare performances among competitors in the same industry. In that way, tourism industry enterprises will go on in better direction, through improvement of their offer and better cost - effectiveness.

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