Structuring strategic management with ratio analysis method: a case study in the transition to SME TFRS process

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Abstract

Techniques such as SWOT Analysis, Balanced Scorecard, and Quality Function Deployment (QFD), which are the most acknowledged and used strategic management methods in business management, were used in various studies individually or in combination. On the other hand, especially executive managers in small and medium-sized enterprises do not have the competence of using financial tables to support their strategic, operational and tactical decisions. The most important aim of the financial reporting by accounting system is to produce reliable, understandable and comparable information and fulfill the needs of the user. Realistic presentation, producing accurate and reliable information, providing transparency, giving the sufficient information that will meet the needs of the user and building a global accounting language in order to provide comparability of global applications are the main goals and objectives of the regulatory authorities in accounting. Global attention drawn by published international financing reporting standards and its ability to provide uniformity in different country applications, reveal the need for specific studies for small and medium-sized enterprises on this subject.

The aim of this study is to evaluate the financial tables by ratio analysis in a small and medium-sized enterprise and determine the effects on strategic management decisions and to evaluate the contribution of these data on building corporate strategies.

Keywords: Ratio Analysis Method, Strategic Management, Financial Tables Analysis, Strategic Decision

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1. Introduction

More than 98% of the enterprises operating in Turkey are SMEs. Based on a study conducted by Ankara Chamber of Commerce, considering the lifetime of these enterprises, 80% couldn’t survive until their fifth year while 96% couldn’t survive until their tenth year. The length of lifetime of the enterprises depends on how well they are managed. Therefore, the result of this study shows that there are some deficiencies in taking strategic decision in SMEs.

Several analysis techniques were developed within the framework of strategic management. Some of the major techniques can be listed as SWOT analysis, BCG matrix, experience curve, scenario analysis, gap analysis, industry life curve, corporate report and quality function curve. A part of these analysis techniques are often used today. However, the aforesaid analysis are limited in terms of seeing the organization as a whole. Besides, it minimizes the effect of accounting function in strategic management.

One of the main reasons why the effect of accounting function is handled in a limited manner or not assessed by the administration is particularly the fact that financial table analysis is not known and the effect of analysis on determining the strategies is not understood. Besides this, the fact that the financial tables do not reflect the actual situation doesn’t bring assessment regarding financial tables into agenda.

Thus, while a case and environmental analysis is made for the businesses, it is necessary to ensure the effect of financial structures in the system is assessed and related accounting data are used in the decision mechanisms.

In the case study conducted, it is aimed at revealing the effect of analyzing financial tables with ratio analysis method on strategic decisions.

2. Theoretical Framework Regarding Strategic Management

Strategic management is generally defined as the whole set of decisions and activities for developing and implementing effective strategies and assessing and controlling them. Strategy is determining the goals and purposes of the organization and rearranging the necessary activities to realize these goals by analyzing the relationships between the organization and its environment and allocating the sources needed in a way that they will be effective in the long run (Dinçer, 2003; p.35).

Strategic management consists of research, review, assessment and selection efforts required for planning strategies; putting into action any kind of precautions within the organization in order for these strategies to be implemented and all activities related with controlling the works performed (Thompson and Strickland, 2003). Strategy is the whole set of activities that emerges as a result of rational planning (David, 2009; 36-37). There is an environmentally friendly approach, not a mechanical one (Ackerman and Eden, 2010; Ambrosini and Bowman, 2010).

Strategic management covers comprehending the conditions of external environment and rivalry to the extent that they are related with the organization, establishing detailed strategies for various product/market combinations, determining the alternatives and sources by focusing on critical fields, transforming strategies into programs in functional sections, coordination in reaching the main purposes and forming suitable planning, motivating and control systems to implement strategies effectively (Ülgen 2000; 25). Benefits from a strategy are listed as follow (David 2009; 47; Akgemci and Gülec, 2009);

- It ensures organization’s adaptation to the environment and thus its long term survival.
- It makes it possible to assess the environment and estimate future (Ketokivi and Heikkila, 2003).
- It creates the opportunity for a self-assessment for the organization.
- It enables direction towards a common goal as a whole within the organization and also consistency (Bungay, 2011).
- It leads activities to a certain direction and forms a framework for plans.
- It increases management performance (Boyne and Walker, 2010).
- It minimizes the risks to take decisions that will be regretted (Eren, 2002; 22).
Since strategic management is future oriented and related with the organization’s long term goals, it is a function of the top management (Ertuna, 2008). However, it guides lower level managers, thus ensures coordination. As the system is handled as a whole, it reviews organization’s goals and society’s interests in integrity (Dinçer, 2003). Decisions taken within strategic management can be classified as strategic, managerial and operational decisions (Üreten, 2002).

Strategic decisions the ones related with arranging the relationships between the organization and the environment it operates in and with selecting the field of activity.

Managerial decisions are related with forming the organizational structure of the business and assets and sources planning.

Operational decisions are about ensuring exchange of sources in the most effective way possible. Analysis made in order to form the basis for the decisions to be taken while analyzing financial tables, classifying them according to the purpose of analysis and realizing the managerial functions are called management analysis (Akdoğan and Tenker, 2007, p.550). Management analysis can be used effectively in taking strategic, managerial and operational decisions in organizations.

3. Ratios Regarding Financial Tables Analysis

Analysis made by examining the balance sheets of organizations generally gives information about the current status of the organizations and their sectorial power. The general purpose of analyzing financial tables is to examine the relationships among various items rather than the numbers and revealing the liquidity status, financial strength, profitability of the firm and its performance in activities more reliably.

While assessing the financial status, profitability and efficiency of the organization, relationships among items become more meaningful than actual numbers existing on the financial tables; therefore, ratios are mostly used in financial table analysis (Akgücü, 2006, p. 362).

In ratio analysis, relationships that are related with each other are put forth. The important thing is to integrate the ratios that serve as financial tools with the purposes of the organization and assess and interpret them. It is possible to achieve the expected benefit from ratio analysis only by interpreting the calculated ratios well and investigating the reasons. It is mandatory that some references be used in interpreting the ratios. These references can be the ratios from the previous years of the organization while they can also be the ratios developed for the sector the business is operating in. Along with the sector, economic conditions of the country should be considered while interpreting the ratios (Akgücü, 2006, p. 362).

It is possible to examine the ratios used in financial analysis in four main groups based on their forms of use in the assessment of business activities (Akdoğan and Tenker, 2007, p.643):

1- Ratios Used in Analyzing Liquidity Status (Liquidity Ratios): These are used for measuring the firm’s ability to pay its short term debts and determine whether working capital is sufficient or not.

2- Ratios Used in Analyzing Financial Structure (Financial Structure Ratios): These are the ratios that help analyzing how balanced and accurately firm’s assets are financed. In other words, financial structure ratios show the relationship between the firm’s foreign assets and shareholder’s equity.

3- Ratios Used in Analyzing Business Operations (Operating Ratios): Operating ratios are used to analyze the financial risks caused by the firm’s operations and analyze the firm’s performance as a result of these operations.

4- Ratios Used in Analyzing the Profitability Status (Profitability Ratios): These ratios are used both in determining whether the firm operates profitably in all of its operations as a whole and measuring and assessing the efficiency of a basic operation.
4. TO FORM A STRATEGY BY USING RATIO ANALYSIS METHOD: CASE ANALYSIS

The ratios and evaluations of the financial statement of the analyzed company – covering the years 2009-2010-2011- are shown below:

4.1. Liquidity Ratios

<table>
<thead>
<tr>
<th>Company Ratios</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LIQUIDITY RATIOS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET WORKING CAPITAL</td>
<td>-157,466</td>
<td>1,168,645</td>
<td>861,465</td>
</tr>
<tr>
<td>(current assets – short term liabilities)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CURRENT RATIO</td>
<td>0,87</td>
<td>1,85</td>
<td>1,66</td>
</tr>
<tr>
<td>(current assets / short term liabilities)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ACID TEST RATIO</td>
<td>0,86</td>
<td>1,80</td>
<td>1,66</td>
</tr>
<tr>
<td>(current assets – stocks / short term liabilities)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CASH RATIO</td>
<td>0,0079</td>
<td>0,65</td>
<td>1,15</td>
</tr>
<tr>
<td>(Liquid assets – short term liabilities)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Net Working Capital:** The increase in 2010 is due to the large growth of the current assets compared to short term debts. The main cause of this raise in current assets is that, the company’s cash sales multiplied. In 2009, net working capital was negative meant that, the company had problems in balancing short term debts.

**Current Ratio:** The current ratio under 1, in 2009, means that the company couldn’t balance its short term debts, by its current assets. The main cause of the raise in 2010 is the increase in sales profit; due to the increase in company’s sales (3% in 2009, 13% in 2010, 10% in 2011).

**Acid Test Ratio:** Having no stocks, caused the company to have acid test ratio values close to current ratio. The company has kept too much money in bank in 2010 and 2011, and this may cause the profitability of the company negatively.

**Cash Ratio:** The company had problems in cash, in 2009 but got better in 2010 with some decisions made. The increase in 2010 is due to the increase in sales and sales profitability; the increase in 2011 is due to the received credits.
4.2. Financial Structure Ratios

<table>
<thead>
<tr>
<th>RATIOS</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FINANCIAL LEVERAGE RATIO</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(foreign earned income /net assets)</td>
<td>0.76</td>
<td>0.53</td>
<td>0.44</td>
</tr>
<tr>
<td><strong>FINANCE RATIO</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(basic capitals / foreign capitals)</td>
<td>0.30</td>
<td>0.89</td>
<td>1.23</td>
</tr>
<tr>
<td><strong>NON-CURRENT ASSETS / BASIC CAPITAL RATIO</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.42</td>
<td>0.04</td>
<td>0.46</td>
</tr>
<tr>
<td><strong>NON-CURRENT ASSETS / CONTINUOUS CAPITAL</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.42</td>
<td>0.04</td>
<td>0.46</td>
</tr>
<tr>
<td><strong>BASIC CAPITAL / TOTAL ASSET</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.24</td>
<td>0.47</td>
<td>0.56</td>
</tr>
<tr>
<td><strong>SHORT TERM LIABILITIES / TOTAL LIABILITIES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>SHORT TERM LIABILITIES / TOTAL DEBITS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.77</td>
<td>0.53</td>
<td>0.45</td>
</tr>
</tbody>
</table>

**Financial Leverage Ratio:** The company’s financial leverage ratio is continuously decreasing within the years. This means, the risk level is also decreasing continuously. The reason why this ratio is decreasing is that; the company is using, foreign earned income constantly but the basic capitals increasingly. And the increase in basic capitals is that the profitability of the company is increasing.

**Finance Ratio:** The finance ratio of the company is very low in 2009; which will cause a pressure on the company by the third party creditors. The reason why this ratio is low is that; the company is using more foreign earned income than basic capital.

**Non-Current Assets / Basic Capital Ratio:** The company’s investment in non-current assets are not many as viewed. Except 2009, financing non-current assets was based on capitals. In 2009 and 2011, what caused the non-current assets greatness was; the paid cash expenses belonging to the future.

**Non-Current Assets / Continuous Capital (LTFEI+BASIC CAPITAL):** As the company is not using long term foreign earned income; the ratios are the same as non-current / basic capital ratio.

**Basic Capital / Total Asset Value:** The company was financed mostly by foreign earned income in 2009; and in 2010 and 2011 the ratio reached the desired levels.

**Short Term Liabilities / Total Liabilities:** The ratio is stable because the company didn’t use any long term earned foreign income and has no trouble in paying the debts back.

**Short Term Liabilities / Total Debits:** The ratio is the same as the financial leverage ratio because the company’s all foreign earned income is formed by short term foreign earned income. The ratio’s tendency to decrease by the years means that, the company will be financed by basic assets mostly.
4.3. Operation Ratios

<table>
<thead>
<tr>
<th>RATIOS</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATION RATIOS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CURRENT ASSETS TURNOVER RATE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(net sales / average current assets)</td>
<td>9,5</td>
<td>7,00</td>
<td>5,34</td>
</tr>
<tr>
<td>ASSETS TURNOVER RATE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(net sales / average assets)</td>
<td>6,4</td>
<td>6,03</td>
<td>4,56</td>
</tr>
<tr>
<td>BASIC CAPITAL TURNOVER RATE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(net sales / average basic capital)</td>
<td>24,22</td>
<td>15,83</td>
<td>8,87</td>
</tr>
<tr>
<td>CREDIT TURNOVER RATE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(total credit sales / average trade accounts receivable)</td>
<td>0,84</td>
<td>1,10</td>
<td>0,07</td>
</tr>
</tbody>
</table>

**Current Assets Turnover Rate:** It is observed that; the turnover rate of the company is decreasing slowly in the years 2009 – 2010 – 2011 which means; current assets are not sufficient in 2009; but increasing slowly and the company has liquid assets, more than needed.

**Assets Turnover Rate:** The tendency of the decrease of the assets turnover rate means that the company profitability may decrease but the company risk has tendency to increase.

**Basic Capital Turnover Rate:** The continuous decrease of the basic capital rate means that basic capital of the company is used unproductive.

**Credit Turnover Rate:** The rapid decrease in 2011 is caused by, the collection of the accounts receivable and the less credit sales.

4.4. Profitability Ratios

<table>
<thead>
<tr>
<th>PROFITABILITY RATIOS</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>GROSS SALES PROFITS / NET SALES</td>
<td>0,02</td>
<td>0,13</td>
<td>0,12</td>
</tr>
<tr>
<td>OPERATING PROFIT / NET SALES</td>
<td>-0,04</td>
<td>0,06</td>
<td>-0,09</td>
</tr>
<tr>
<td>PROFIT FOR THE PERIOD / NET SATES</td>
<td>-0,04</td>
<td>0,06</td>
<td>-0,086</td>
</tr>
<tr>
<td>NET PROFIT / NET SALES</td>
<td>-0,04</td>
<td>0,06</td>
<td>-0,071</td>
</tr>
</tbody>
</table>

**Gross Sales Profits / Net Sales:** The ratio of gross sales profit to net sales is 0.02; in 2009. This means, the company profits 2 Turkish Liras from every sale of 100 Turkish Liras. This amount increased to 13 Turkish Liras in 2010; but decreased to 9 Turkish Liras in 2011.
Operating Profit / Net Sales: The main activities of the company ended in 2009 with loss. In every sale of 100 Turkish Liras; 6 Turkish Liras turned to “operating profit” in 2001; but in 2011 every 2 Turkish Liras, was profit.

Profit For The Period / Net Sales: The main activities of the company ended in 2009 with loss. In every sale of 100 Turkish Liras; 6 Turkish Liras turned to “profit for the period” in 2010; but in 2011 every 2 Turkish Liras, was profit.

Net Profit / Net Sales: The main activities of the company ended in 2009 with loss. In every sale of 100 Turkish Liras; 6 Turkish Liras was taken as “net profit” in 2001; but in 2011 every 2 Turkish Liras, was profit.

5. Strategic Recommendations

Operational, administrative and strategic decision recommendations that can be provided following the analysis of the last three years’ financial tables of a company with ratio analyses technique can be classified as follows:

Operational Decisions

1. In order to increase the sales income of Company X, it is necessary to evaluate the sales price and increase prices, if possible.
2. As banks’ interest rates are very low, instead of interest income it will be more profitable to use the ready cash in a way that will increase the income or decrease expenses.
3. In order to decrease the cost of sales good or services, company should try to purchase higher amounts and decrease the cost of purchase.
4. Even in case of low debts to suppliers, company should try to get a discount for early payments or cash purchases.

Administrative Decisions

1. X Company has not experienced a significant cash flow problem except 2009. However, using company sources in an unproductive or unprofitable way is the main problem of this company. Funds that are transferred to company must be used productively. The main reason of the success obtained in 2010 is high sales profit.
2. As the company is losing money, it is not necessary to increase capital. First of all, in order to obtain continuity of the company, necessary precautions (decreasing sales costs or increasing sales earnings) must be taken in order to increase profits from the main business segment. Otherwise, increasing capital will not be a precaution that will help to the company durability.
3. In case of capital increase, it becomes important where this source will be used. For example, if this cash flow is going to be kept in the bank, it will not provide any contribution.
4. In general, regarding administrative expenses;
   a. In order to cover the general administrative expenses, X Company must obtain a profit at least the amount of these expenses. If a company cannot cover operational expenses, it is inevitable for it claim damages. In case the companies’ earnings are just as much as to cover it is expenses, then this will only make it even. Thus, it is appropriate to aim a higher profit (sales profits) goal.
   b. The structure of the general administrative expenses must be evaluated. The expenses in question are thought to be consisting of fixed expenses such as employee payment and expenses. The
alternatives for decreasing these expenses must be sought. Is the same business quality can be obtained with few personnel? In other words, personnel numbers must be reevaluated and all precautions must be taken to obtain same quality.

**Strategic Decisions**

1. Getting a long-term loan and transferring it to investment (such as buying real estate to provide business continuity) can contribute to long-term profitability of the company. For example, it may help to get rid of rent expenses and decreasing costs.
2. Using this transferrable source for partnerships with supplier companies, which provide management inputs, not only may contribute to make a long term investment and but decrease the sales costs of the company also.

**Conclusion**

The basic objective of the accounting system is to provide useful financial information to the parties that will help their decision making process about the company. Accounting’s realization of its objectives exactly depends on the reliability of the system. Correct decisions can be made only if the appropriate data analyzed precisely. Only this way accounting can be an effective management tool that can be useful for in advance planning of activities and interpreting financial activity results during decision-making process.

The durability of a profit company can be obtained by reaching all of the primary goals together. Most concrete data on the financial status and activity results of a company can be obtained from accounting system. Thus, it is important to use accounting system effectively during strategic management process.

Currently;
- New Turkish Commercial Code,
- Transition to SMEs TFRS (Turkish Financial Reporting Standards for Small and Medium-sized Enterprises),

are very important developments for the future of accounting system.

Transparency and corporate management rulings, which were not included in commercial legislations until now, are included in the New Turkish Commercial Code. With these rulings, for the first time in our legal regulations, accounting is positioned to be for transparency, but not for taxes.

SMEs accounting standards will give the opportunity of being in the international arena for the SMEs of developing countries and equity will be obtained between SMEs. Similarly, problems will be avoided when an enterprise size expands, change class, and transfers to complete standard set. For these reasons, accounting standards are published for SMEs and effective date left to each country’s preference in order to apply when the country is ready. For our country, date of transition to Turkish financial report standards for SMEs is 01 January 2013. Thus, as all SMEs in the World will be using the same accounting standards, the financial reports will be comparable and contribute to the World commercial development, as it will increase the reliability.

These developments can be evaluated as an indicator that the accounting system will be used more effectively during the strategic management process. Institutionalization process of SMEs is related to long-term decision-making and the planning competence of enterprises. New regulations of accounting system that must be followed will force the
enterprises and SMEs in particular, to plan strategically and self-development on strategic management, accordingly. In this context, it is anticipated that the number of scientific studies on penetration between new accounting regulation and strategic management will increase.

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