THE EARNINGS PER SHARE MIRAGE

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Abstract: *There are two accounting main systems worldwide, and namely the accrual accounting and the cash accounting. Within an accrual accounting, like the Romanian accounting system is, too, there are time intervals between recognizing an expense or an income and the moment when they are paid or cashed. Thus, within such an accounting system is more difficult to get an accurate image of a company's activity. Also, there are no stock market indicators within the nowadays financial statements from our country and, in this way, the accurate image of the listed companies' activity is even more distorted. But these companies have usually a large amount of activity, generating huge cash flows that is important to be followed in the most careful way possible. The present paper aims to emphasize the importance of the stock indicators within the financial statements content and, in a particular way, the importance of the "Earnings per Share" position for the financing, investment and operating decisions within a stock listed company*.

Key words*: listed company, stock indicators, Earnings per Share, financial statements, accrual accounting*

INTRODUCTION

The main users of accounting information, the investors, realize the importance of financial statements, in terms of outlining the investment opportunities [5].

It is well-known the fact that the decision-making chain, the more extensive it is through the existence of a number of intermediaries, it reversely affects the usefulness of financial statements [4]. However, „the operational decision makers" recourse, in a large measure, to accounting information, especially when there are no other sources of information on the trend followed by the concerned companies [7].

Apart from the information asymmetry that establishes between investors and managers, the accounting information constitutes itself in a determining factor for the market value of the entity. In other words, the market capitalization is significantly influenced by the accounting information [14].

The dilemma arises when choosing an accounting indicator, presumed to be relevant in shaping the investment strategies on financial markets [12].

MATERIALS AND METHODS

In order to complete the present study, various research methods are used, such as: the analysis, the synthesis, the induction, the deduction, the brainstorming or the case study [1].

RESEARCH RESULTS

Currently, informing the investors is based on many sources of information, more or less accurate. The reasoning of the fluctuations on financial markets reduces itself to the modeling of the cause - effect type relations. Moreover, given the globalization of national economies and the internationalization of financial markets, the investors find a close connection between the effects of their decisions and the ones that are external to companies [8].

Therefore, a correctly informing constitutes a prerequisite condition in order to ensure the conservation and the development of the amounts invested by financial market participants [13].

Indeed, current practice positions the financial ratios system as an effective way of informing the internal and external decision factors of the entity [15]

Although, the specialty practice involves construction of a whole array of indicators, often differentiated according to the interests pursued by each of the users of accounting information, the accounting legislation requires companies the calculation and reporting only a small set of such indicators [3].

Table 1.

Indicators from the notes related to the financial statements

Indicators Group	Indicator Name	Way of Calculating
Liquidity indicators	Current liquidity	$\frac{CurrentAssets}{CurrentLiabilities}$
	Immediate liquidity	$\frac{CurrentAssets - Stock}{CurrentLiabilities}$
Risk indicators	Indebtedness	$\frac{BorrowedCapital}{Equity} \times 100$
	Interest coverage capacity	$\frac{EBITDA}{Interests}$
Management indicators	Inventory turnover	$\frac{SalesCost}{MediumStock}$
	Storage period	$\frac{MediumStock}{SalesCost} \times 365$
	Rotation speed of receivables	$\frac{MediumReceivables}{Turnover} \times 365$
	Rotation speed of the commercial credit	$\frac{MediumSuppliersDebts}{Supplyings} \times 365$
	Rotation speed of tangible assets	$\frac{Turnover}{FixedAssets}$
	Rotation speed of total assets	$\frac{Turnover}{TotalAssets}$
Profitability indicators	Return of the equity engaged	$\frac{EBITDA}{Capital}$
	Gross margin of sales	$\frac{GrossIncomeFromSales}{Turnover}$

Source: own elaboration

According to the OMPF 1802/2014, in the notes accompanying the financial statements, firms must report a number of financial indicators covering several directions of financial analysis [2]:

- liquidity indicators, which provide clues to the entity's ability to meet payments due for the current period by reporting various aggregates of the assets to the current liabilities;
- risk indicators, which refer, in particular, to the financing structure of the entity and the risks incurred by the sources of financing opted for, either through

structural analyzes of the components of liabilities, or by reporting the income achieved to the financial commitments arising from the financing conditions;

- management indicators, build towards providing essential information on the rotation speeds of assets on tax value, supply policies optimality and crediting customers;
- profitability indicators, reflecting the entity's ability to emit profit from its own activity, by expressing the benefit derived from the use of economic capital used or by reflecting the trade margin policy practiced by entities.

Therefore, we detect a new direction for improving the financial statements, which could be reflected in a structured and logical development of a complex of „dashboards", designed for each group of users of accounting information. But notwithstanding the efforts of the Romanian formalizers in order to identify solutions for better informing the users of accounting information through a system of kinetic rates expanded, the difficulties make their task hard as long as there will not be any solutions of softening the creative accounting techniques [6].

Unfortunately, none of these indicators proposed to be calculated on the explanatory notes is considered sufficiently „eloquent" in determining certain investment strategies. The main reason is that investors are focusing their attention on complex indicators, constructed starting from indicators calculated on the basis of the information of flow and, also, on the information of stock. Justification of the adherence to such an approach by installments is based on several reasons, depending on the individual information needs. The truth is that, in recent years, specialists have received hard lessons about the importance of each financial statement [10].

Not long ago, to the balance there was not given the proper endorsement in financial analyzes underlying the investment decisions. However, the real economy has pierced with adverse effects, erroneous preconceptions supporting the information of flow recorded in the profit and loss account, are the only relevant in the decision making. Today, experts amount to the same rank the balance sheet and the profit and loss account, and, more recently, the cash flow statement, and charge the accounting information in an integrated vision [6].

Therefore, from this point must start the efforts of the Romanian formalizers in order to establish the basis of an integrated array of financial and management ratios, designed to bring „rays of light" in the investment approach [11].

Above all these, the IAS 33 „Earnings per Share" proposes an aggregate indicator that seems to be accepted by the vast majority of financial market actors, namely the Earnings per Share. This indicator has two levels of calculating, namely the Basic Earnings per Share, respectively, the diluted Earnings per Share, determined by dividing the net accounting income attributable to common shareholders to the weighted average of ordinary shares outstanding during the period [7].

The difference between the two levels of calculation is generated by the various financial engineers made by the entity through policies to attract finance. These financing policies aim at minimizing the risks of financing and the financing costs incurred by offering creditors the right to convert the debt securities into equivalents of the property titles of the debtor entity [2].

Therefore, the denominator for the two indicators differs because the convertible debt securities are considered potential dilutive shares, and as such, will be added to the ordinary shares already taken into account in determining the Basic Earnings per Share [3].

The Basic Earnings per Share (RAB) is determined according to the relation:

$$RAB = \frac{Net\,Profit - Preferential\,Dividends}{Weighted\,Average\,Of\,The\,Ordinary\,Shares},$$

where *Preferential Dividends* represent the dividends corresponding to the preferential shares and the following calculation relationship establishes:

The number of common shares outstanding at the beginning of the year
- The number of common shares repurchased × The number of months in which the shares have been in circulation $\times \frac{1}{12}$
+ The number of common shares issued × The number of months the shares have been in circulation $\times \frac{1}{12}$
= Weighted Average of the Ordinary Shares

The usefulness of such an indicator is not insignificant, as long as we know, big companies listed on capital markets, suffer in the own structure of capital many changes from one period to another. In these cases, a pertinent analysis of the potential informational indicator „Earnings per Share" is achievable only if it is also called the information reported in the statement of changes in equity [8].

The information included in this summary report is all the more true as the traceability of the information recorded can be proved without much difficulty.

Moreover, this indicator is among the most commonly used indicators at a national and international level. Many investors use, in addition to exchange rates or stock market multiples, also exchange indicators related to share, including dividend per share and sales per share or Earnings per Share [9.

Although the Earnings per Share cannot be used in the comparison of two companies with different capital structures, its variation directly affects the level and trend of exchange rates, in the absence of the information asymmetry. Exchange rate PER (Price Earnings Ratio) is considered the most used of the market rates. It is determined by calculating the expression $PER = \frac{Share\,Exchange\,Value}{RAB}$, only if we talk about the recorded profit. This rate is the most strongly influenced by the Earnings per Share, representing a clear proof of the usefulness of the accounting information also on the financial markets. But, by building, this indicator raises questions about the correlation between the exchange course and Earnings per Share because the exchange course is heavily influenced by the historical evolution of the basic Earnings per Share. This view is supported by statistical studies showing that the current PER is higher than the previous one, while previous PER is higher than the forecasted one, whereas it is estimated that future profits will be higher than the previous ones [2].

Taking into consideration a listed company situation, on a 5 years period, we have the following situation (Table 2).

Therefore, we consider another way of improving the financial statements, that being the addition in the structure of the financial statements of a unique section forecasting the results and the future cash flows, integrated into a multiannual array of foresight in order to help also in a forward-looking design of the stock indicators of the balance sheet [6].

Table 2.

Indicators of a listed company for a 5 years period

Indicators/Year	N-4	N-3	N-2	N-1	N
Market capitalization (mil. LEI)	26.712 lei	32.004 lei	28.152 lei	10.253 lei	14.104 lei
The market capitalization (mil. EUR)	7.264 €	9.077 €	8.056 €	2.609 €	3.356 €
Maximum price (LEI/share)	0,530 lei	0,655 lei	0,620 lei	0,560 lei	0,292 lei
Minimum price (LEI/share)	0,276 lei	0,441 lei	0,479 lei	0,129 lei	0,116 lei
Price at the end of the year (LEI/share)	0,477 lei	0,565 lei	0,497 lei	0,181 lei	0,249 lei

Source: own elaboration

In addition, given the practicability of the net accounting profit arising from operating an accrual accounting basis, Earnings per Share is useful to major shareholders and investors seeking long-term investments within the capital of the entity.

Controversies of value arise only regarding the informational value of the counter, representing the net accounting profit, which, as mentioned, is strongly influenced by the creative accounting techniques. The impact of taxation on the accounting act speaks again, through arbitration of the conflict of interests' state - entity, with the potential tax savings stake. Remaining within this framework of analysis, we can still distinguish a direction of improvement of financial statements by addressing accounting act in the context of a cash accounting scheme. Only in such circumstances, the net accounting profit can be seen with certainty as a real performance of the entity. But in this case, despite the fact that an accrual accounting reflects an extreme prudential policy, regarding the receiving rights, the ability to predict the future fund flows is strongly affected [2].

Taking again in consideration the listed company mentioned above, the stock exchange evolutions during the 5 years interval is presented as it follows (Figure 1):

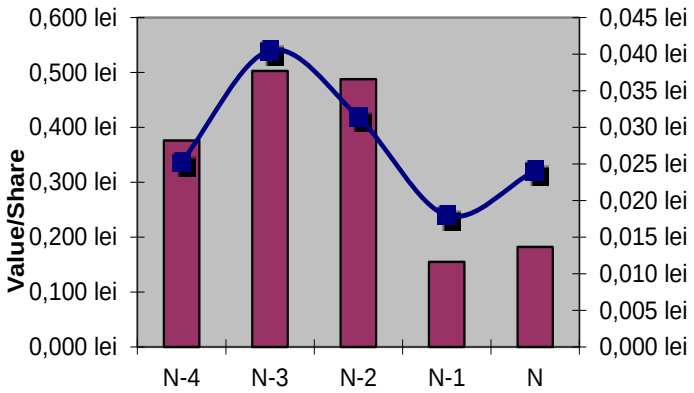

Figure 1. The stock exchange evolution of a listed company during a 5 years period

CONCLUSIONS

While advocating for a treasury accounting constantly, let's not forget also the relevance of the information on expenses and income recorded in the income statement. This document provides useful information in order to calculate the historical yield of the entity, traces clues to the uncertainty of the cash flows, the veracity of this information being assured as long as the principle of the independency of the exercise, duplicated by the principle of establishing the revenues and the principle of connecting expenses to the revenues are respected [6].

However, the volatility of the information received from the capital market reveals, in the case of the listed company, a significant gap between the exchange course and accounting net income per share respectively.

Although it is noted that during the period N-4 - N-2, the ratio of dividends distribution is increasing as a result of unstable and decreasing earnings per share, the exchange course drops, due to a dramatically low capitalization.

Table 3.

Stock Exchange for the listed company during a 5 years period

Indicator/Year	N-4	N-3	N-2	N-1	N
Earnings per Share (LEI)	0.025 lei	0.041 lei	0.031 lei	0.018 lei	0.024 lei
Dividend per Share (LEI)	0.013 lei	0.018 lei	0.019 lei	0.000 lei	0.000 lei
Average Exchange Course per Share (LEI)	0.377 lei	0.503 lei	0.488 lei	0.155 lei	0.183 lei
PER (LEI)	14.881 lei	12.420 lei	15.541 lei	8.611 lei	7.573 lei
Δ	-	-2.462 lei	3.122 lei	-6.930 lei	-1.038 lei
%	-	-16.54%	25.13%	-44.59%	-12,.06%

Source: own elaboration

We conclude, therefore, to the idea of reintroducing within the financial statements content of the position which disclose the size of the earnings per share, by both its informational facets, basic earnings per share, and respectively, diluted earnings per share [9].

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