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ANALYSIS OF CORPORATE OPERATIONAL PERFORMANCE: INTERPRETIVE ISSUES AND QUANTITATIVE DETERMINATIONS

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Abstract

Operational management is not a unanimously accepted concept at the international doctrinal level. If, for example, we compare the tax laws of the various nations and the international accounting standards or national accounting standards of the different countries, we can see that the concept of operational management differs depending on where we find this notion. Since operational management is essential in delving into a company's profitability, it is first necessary to identify an operating management concept that is useful for data analysis to be an efficient and effective tool for identifying the most appropriate steps for maximising company profitability. The first step in this process is to identify an operational management concept that does not change depending on the area in which we are acting. Thus, the same concept must apply in the profitability and financial spheres, should this concept be used to analyse a company's financial situation. And it is also necessary for the same concept to be present in the area of the study of monetary flows because if the concept of operational management or other concepts that are used to study this type of activity change depending on the sphere in which we are acting, the analysis will be confusing and will lead to an incorrect interpretation of the results obtained. A second very relevant element to be noted is that the in-depth analysis of operations is often done incorrectly by comparing ROA with the ROI trend and thus interpreting the trend of active financial management and asset management residually. If this is done this way, the analysis results can be misleading. It is necessary to conduct a more in-depth analysis that considers other variables, which will discuss in more detail in this article.

Keywords

Operating Performance, ROA, ROI, Core Business

1) OPERATIONAL MANAGEMENT: MEANING AND INTERPRETATION ISSUES[1]

Monitoring a company's operational performance is the first fundamental step to interpreting the company's overall economic situation correctly and comprehensively. Operational management identifies the fulcrum of entrepreneurial activity from which, at least in theory, the income and financial 'energies' that feed the company's complex management should flow.

However, an in-depth examination of this issue requires a prior methodological observation. As is well known, within the study of the economic-financial business model, the terminology is characterised by two peculiarities:

- there are unambiguous concepts identified by different terms
- and there are lemmas that, depending on the context, can take on different meanings.

This terminological 'problematic' is potentially a harbinger of dangerous misunderstandings in that interlocutors, without having an accurate perception of the problem, may refer to different subjects while using the same terms or, on the contrary, they may use different definitions to illustrate the same concept.

[1] To facilitate reading, I have decided not to include in the text, except in exceptional cases, the names of the scholars who have dealt with the subject under analysis since the bibliography is endless, I have opted not to indicate all the terms of the scholars in the text because this would have meant a continuous interruption of the reading of the complete sentence in which I express my thought.

Such eventualities increase further if the in-depth study's ultimate objective is identifying a potential 'hypertextual' link between different subjects and disciplines.

As a mere example, consider the definition of a company.

In Italy, jurists, based on the definition provided by the civil code, identify the company as a material concept consisting of assets. From this material notion, one can go as far as the organisational-personal notion of the corporatists, passing through the spiritual-animist idea of the institutionalists.

This is not the most appropriate place to delve into the consequences of such a situation, but highlighting the problem is highly relevant to understanding the terms of the subject matter of this work.

The monitoring of operational profitability requires, in fact, a prior definition of what is to be understood by business operations. Without such a definition, it is impossible to delve into its parts.

The choice of the concept of operativeness, therefore, represents a fundamental element of the entire subsequent analysis, hence the importance of correctly identifying the constituent part of the concept.

In the first instance, it should note how the economic-financial investigation, in substantive terms, cyeart disregard the contextual analysis of two 'fields' of research: business and tax. The two souls of the study, complementary to all intents and purposes, complement each other through bi-univocal relationships that indissolubly intertwine the elements of the two problems.

The circumstance that the purely business aspects and the tax side of economic-financial values are inextricably linked does not, however, imply the acceptance of a slavish transposition of tax terms from a terminological point of view, peculiar to each nation, into the field of accounting. This is for two reasons:

- firstly, in each country, tax terminology has its raison d'être for objectively identifying the tax base. Therefore, the problem of choosing the correct terms to resolve long-standing 'doctrinal terminological quarrels' does not even arise in the field of taxation. Certain lemmas are dictated only by the pragmatic need to avoid subjective, restrictive and/or extensive interpretations of the phenomena intended to be affected by the tax.

- Secondly, concepts known in the business field are frequently used in the tax field, which, for tax reasons, are 'bent' and 'modified' to achieve the objectives mentioned above.

For these reasons, in no country is it possible to hypothesise either a terminological transposition from tax law to the area of corporate finance or a perfect semantic alignment between the two 'fields' of analysis/research. What is perfectly correct to call in a certain way in the tax area may not be so in the financial reporting-business area.

In Italy, an example of this physiological 'fracture' in terminology concerns the concept of 'operation' precisely.

In Italy, the 2008 Finance Act was initiated using the concept of gross operating income in the tax field. This aggregate identifies the practical reference value for determining deductible financial charges for corporate income tax purposes.

There is no objection to the circumstance that the reference amount is identified with a locution that takes on different meanings in the balance sheet-business area. In purely tax-related terms, the event that different acronyms may identify the aggregate object of interest in places other than taxation has no material significance. The only fundamental element on the subject of tax quantification concerns the necessity that the taxable amount cyeart be distinguished by interpretations and/or details of a subjective nature.

However, at the same time, these considerations irrefutably point out that it cyeart accept the inverse principle either. If, therefore, on the one hand, one accepts the postulate that tax-related terms need not necessarily have an equal terminological match in areas other than taxation, on the other hand, for 'par condicio', the principle must be accepted that the phrases used in taxation-related laws must remain 'confined' to the tax sphere.

The pretence of correctly illustrating concepts without fiscal relevance with terms used in the tax field would inevitably entail the use of terms whose choice does not depend on studies aimed at identifying the 'best' term that can be used to identify a given economic-financial phenomenon, but rather derives from a mere pragmatic option aimed at eliminating any subjectivity in the taxpayers' tax-relevant behaviour.

For these reasons, it is impossible to identify the concept of operativeness by looking for 'help' in the tax field on pain of completely emptying the idea we intend to explore here.

The considerations illustrated above make it clear how the identification of so-called business operations can only draw its assessments from the corporate sphere with the consequent abandonment of any reference to taxation and/or taxation in the broader sense. And this applies to all countries characterised by differentiated tax rules and the use of terms that may be the same but have profoundly different meanings.

Although we have narrowed the helpful research field to correctly determine the concept of operational management, the problem is not, however, entirely resolved.

Even leaving aside all considerations related to the taxation of business income, which varies from country to country, identifying a univocal concept of operations is not a simple initiative.

The doctrinal landscape is marked by writings that use this locution in a very variegated manner and, consequently, characterised by substantial differentiations that, if not correctly interpreted, can lead to fallacious and contradictory analyses.

Using one term in place of another does not cause severe consequences. Indeed, on simple meditation, it would appear that the only practical effect of such a situation is the 'obligation' of having to 'adapt' to the lexicon considered congruous by the author under scrutiny.

This is only true, however, if the analysis focuses on a micro-parsing element of knowledge.

Consider, for example, conducting research concerning, exclusively, the potential reclassification of profit and loss. Such an in-depth study, aimed only at analysing profit and loss aggregates, is certainly micro-parcelled. Indeed, it has no connection with other issues about financial reporting and/or the company in general. Any scholar could use different terms concerning the same concept in this specific hypothesis without creating any particular theoretical problems. Indeed, freedom of thought dictates the acceptance of any lemme concerning any object of interest.

Of course, when dealing with different topics, there is nothing to prevent the same author from using, for example, the same term with different meanings. If the purpose of the research is to analyse micro-topics separate from one another, this is perfectly acceptable and does not create any theoretical and/or operational-pragmatic problems.

It is, in fact, possible that a term is used differently by the various standards, or several terms may have the same meaning. This is the case, for example, if one considers the multiple states' IAS/IFRS or national accounting standards. It may also happen that the accounting standards do not help to solve the problem because the operative term is not used.

An example is the IAS/IFRS international standards, where operational management principles are not used. In the past, IAS 1 contrasted ordinary and extraordinary management regarding profit and loss. For several years now, this contrast has been eliminated as the accounting standards have shown that there can be no extraordinary management of an enterprise. All events are therefore considered ordinary, but the concept of operational management is not used in this international standard.

The notion of operations is found in the IAS 7 Statement of Cash flow which, identifies operations as follows:

“Operating activities

The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are: (a) cash receipts from the sale of goods and the rendering of services; (b) cash receipts from royalties, fees, commissions and other revenue; (c) cash payments to suppliers for goods and services; (d) cash payments to and on behalf of employees; (e) [deleted] (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and (g) cash receipts and payments from contracts held for dealing or trading purposes. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as described in paragraph 68A of IAS 16 Property, Plant and Equipment are cash flows from operating activities. The cash receipt from rents and subsequent sales of such assets are also cash flows from operating activities. An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity. Investing act”

As can be seen, operating activities, as interpreted by the IAS 7 Statement of Cash Flow, is a comprehensive concept that includes several items that are not related to each other. This is also the case in Italy.

Even in Italy, the concept of operating activities can only be found in the cash flow statement proposed by accounting standard 10, the Cash Flow Statement issued by the Italian accounting body. In this accounting standard, two cash flow statement structures are proposed, precisely as in the IAS 7 Statement of Cash Flow: the first is drawn up using the indirect method, and the second is drawn up using the direct method. In both, the first part of the statement is referred to as operations. As in IAS 7 Statement of Cash Flow, from which the Italian Accounting Standard No. 10 Statement of Cash Flows draws its foundation, the concept of operating management cyeart be used to carry out an analysis and of operating management that makes sense. In accounting principle no.

10 issued by the Italian national accounting body, the concept of operating management includes all monetary flows linked to typical costs and revenues, but also monetary flows related to taxes to financial charges and accounts not connected with typical company management payment of severance pay, etc. Until a few years ago, this management was referred to as income management. With the revision of standard number 10, the cash flow statement issued in 2016, income management was called operating management.

Operating management as defined by the Italian accounting standard issued by the Italian Standard Accounting Board, No. 10 Cash Flow Statement, is identified as follows:

	200X	200X-1
A. Cash flows from operating activities (direct method)		
Collections from customers		
Other receipts		
(Payments to suppliers for purchases)		
((Payments to suppliers for services)		
(Payments to staff)		
(Other payments)		
(Taxes paid on the income)		
Interest received/(paid)		
Dividends received		
Cash flow from operating activities (A)		

As can be seen from the above, both IAS 7 Statement of Cash Flow and Italian National Standard No. 10 Cash Flow Statement identify the content of so-called operating activities in a highly diverse set of accounting items and include, in essence, everything that does not include concern investments/disinvestments of tangible, intangible and financial assets and financing from third parties or equity. The highly heterogeneous content of this concept makes it impossible to use that definition to carry out any income-type analysis on operations that makes logical sense at the company level and that can be used to improve the company's situation or to develop useful data for company management to ensure that their actions are effective and efficient and to ensure that the company management's activities lead to the maximisation of income and monetary flows produced by the company's activities.

The concept of operating activities expressed in IAS principle number 7 Statement of cash flow and Italian national accounting principle number 10 cash flow statement cyeart be used to develop a reasoned analysis of a company's income activity.

To identify the area included in operations, the international or national accounting standards of the various nations (all nations that refer to IAS/IFRS have, in fact, concerning the content of operating activities, the same structure as illustrated above about IAS principle number 7 Cash flow and Italian national accounting principle number 10 Cash flow statement) cyeart be used as they provide too broad a concept containing, in essence, everything that is not included in the investment/disinvestment of tangible, intangible and financial assets and the financing activity from third parties or equity

The situation changes radically if the analysis is carried out, not in a micro-parallelised manner, but with the aim of developing a scheme that presents interconnections and relations, univocal and/or bi-univocal, between all the component parts. When such a hypothesis occurs, the analysis only makes sense if each part of the in-depth analysis 'converses' with any other fraction. Any theoretical and/or terminological incompatibility causes what, in medical terms, is called 'syncope'. The system, as such, collapses because what appears to be an 'interrelated set of parts' instead identifies a mere summation of non-communicating elements. Suppose there is a lack of complete and exhaustive compatibility between the components. In that case, the sum of parts does not identify a system but rather a mere aggregation of units without real inter-relationships. This applies to both substantive issues and formal/terminological requirements.

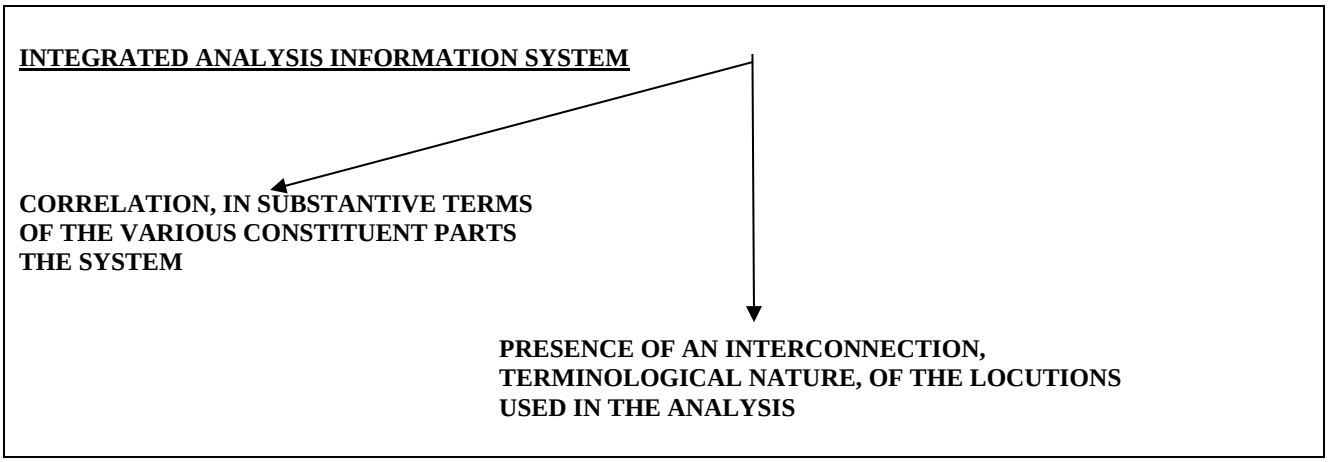
The essence of an analysis of financial reporting or, more broadly, of the company lies in the uniformity, complete and absolute, of the terms used to illustrate certain concepts. Only the presence of this uniformity and cohesion, even in times of terminology, can guarantee the correct reading and interpretation of the management elements studied and explored.

To maximise the communicative and informative effectiveness of in-depth financial reporting, it is, therefore, necessary for companies to adopt an integrated system of analysis.

An analysis scheme can be defined as 'integrated' when it forms a system in the technical sense of the term.

It should be remembered, in this regard, that the concept of a system is based on the principle of interrelation between several elements.

It is only possible to speak of an actual analysis system in such interconnection. The system will have the further connotation of 'integration' if, in addition to a correlation expressible in substantial terms, an inter-connection of a 'terminological' nature can also be identified between the various elements.

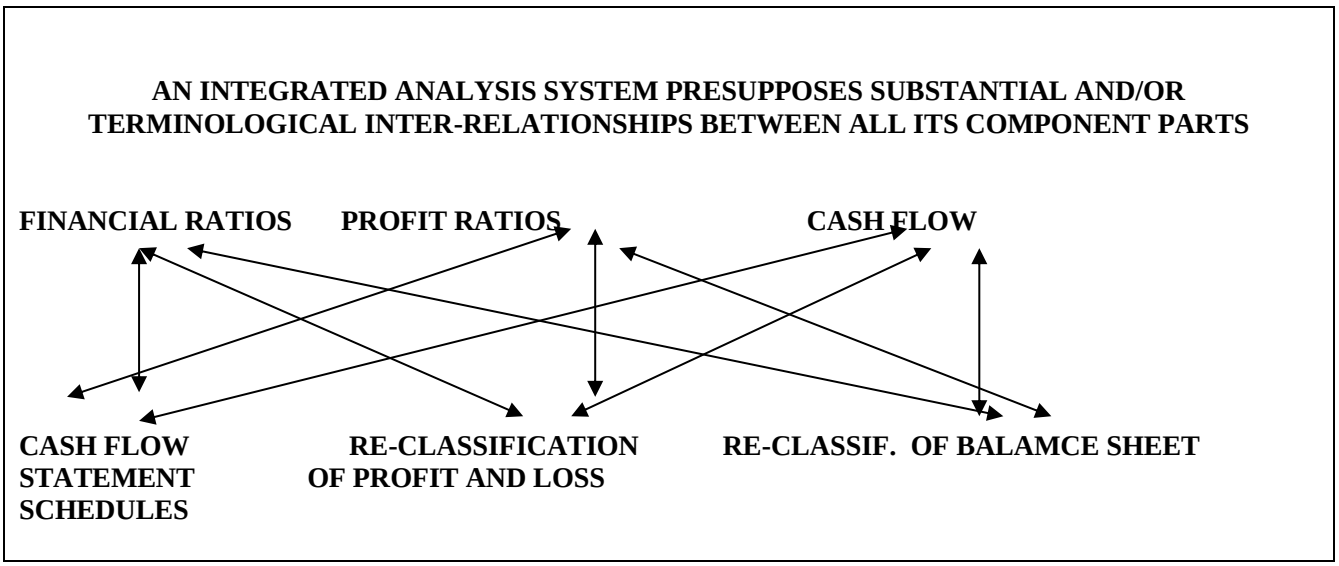


To provide a complete, exhaustive, and, above all, coherent picture of the company's situation, there must, therefore, be full conceptual integration, in terms of both substance and form, within the scope of the analyses performed.

From a substantive point of view, integration must be developed since only in the presence of this characteristic can the conceptual scheme of analysis cover every area that requires in-depth research. Finally, formal integration is indispensable if the analysis results are understood and communicated effectively. Therefore, using the same terms to identify similar concepts appears to be an essential element if the analysis is understandable to all those it is intended for. To connote different ideas with different phrases determines an equally important behaviour for the correct understanding of the results obtained from the in-depth analysis of accounting data.

Therefore, the constitution and use of an integrated system imply the construction of a unitary scheme that permeates each step of the analysis.

As is well known, the analysis uses two indispensable tools: ratios and cash flows. The ratios, in turn, presuppose the reclassification, ex-ante, of the balance sheet and profit and loss. Adopting an integrated analysis system implies a necessary correlation, both substantial and formal, between ratios, dynamic analysis and financial reporting reclassifications.



2) THE INTEGRATED INFORMATION SYSTEM IS INDISPENSABLE FOR THE CORRECT IDENTIFICATION OF OPERATIONAL MANAGEMENT

Based on this consideration, it is evident how the choice of a reclassification scheme has implications that transcend the mere regrouping of accounting data. Using a particular terminology within a reclassification scheme affects the construction of ratios and the choice of financial reporting schemes.

As can be understood from these concise considerations, preparing a reclassification scheme divorced from subsequent analysis appears to be a meaningless exercise. In the same way, the construction of reclassification schemes, financial and income statement ratios, and a cash flow statement characterised by a substantial lack of terminological interrelation appears to be a meaningless operation.

Based on these observations, it is evident how the identification of the concept of 'operational management' transcends the mere pragmatic problem of profit and loss reclassification and permeates, in reality, every part of the system of analysis that those wishing to delve into the performance of company management intend to use.
The concept of operability must find a trait union in every area of in-depth analysis of the company's profit and financial situation. This way, the analysis results can be consistent, perfectly understood and effectively communicated.

To fully understand the reasons for a delimitation of the concept of operational management as accepted in this work, it is necessary to bear in mind how such management, from an economic point of view, must be investigated through the use, not of absolute values, but a profitability concept.

Such a judgement presupposes comparing the capital and the income produced by these assets.

Given the apparent obviousness of the problem, there is no need to dwell on the market for the values being compared to be homogeneous. The comparison of heterogeneous amounts would inevitably lead to the determination of shallow profitability values and, consequently, devoid of any theoretical and/or practical significance.

Such a consideration may seem obvious and almost redundant. In reality, this is not the case. In fact, in many cases, one finds the determination of profitability ratios characterised by a blatant heterogeneity between numerator and denominator, a clear symptom of a logical error in the identification of the assets and/or income being cross-referenced.

To correctly determine the company's operating profitability, it is necessary to compare a meaningful notion of operating income with a coherent idea of active assets from which those mentioned above net economic income can emanate.

What, superficially, may seem useless as being too analytical must, in reality, be read and analysed in the light of the complete integrated analysis system. This analysis must, moreover, be carried out in the knowledge that the true objective of the examination is not the mere deepening of the company's operational area but the analysis of every managerial aspect of the company. Only in this way is it possible to implement a 'logical' breakdown of management with subsequent analysis of the various parts.

To this end, it is necessary to identify a profit and loss scheme that provides a management breakdown consistent with what is expressed, albeit in terms of capital, in the reclassification of the balance sheet.
In particular, it is considered essential that the terms:

* Equity
* Financial
* non-characteristic by definition
* tax

Identify the same 'accrual' areas in the balance sheet, profit and loss and cash flow statement.

This reclassification objective is fully achieved by adopting the following reclassification structures :

RECLASSIFICATION SCHEME BALANCE SHEET/BUDGET BALANCE SHEET IMPLEMENTED AS PART OF AN INTEGRATED INFORMATION SYSTEM.

ASSETS	31/12/N	LIABILITIES AND EQUITY	31/12/N
SHORT-TERM ASSETS		**SHORT-TERM LIABILITIES**	
1 Immediate liquidity		1 Short-term financial liabilities	
2 Deferred liquidity			
* Trade receivables			
* Financial liquidity			
		2 Short-term tax liabilities	
* Tax-deferred income			
* Non-characteristic deferred income			
3 Availability(inventories)		3 Short-term non-financial liabilies	
4 Short-term assets non characeristic			
5 Advances to trade suppliers			
LONG-TERM ASSETS		**LONG-TERM LIABILITIES**	
1 Long-term tangible assets		1 Long-term financia liabilities	
2 Long-term intangible assets		2 Long-term tax liabilities	

LONG-TERM ASSETS		**LONG-TERM LIABILITIES**	
3 Long-term credit assets * Trade accounts receivable * Financial assets * Tax assets * Non-typical accounts receivable		3 Long-term non financial liabilities	
		EQUITY	
4 Long-term assets non characteristic			
Stand-alone items		**Stand-alone items**	
NET ASSETS		**BALANCE TOTAL**	

- immediate liquidity includes everything that is already cash and cash equivalents;

- by definition, deferred cash includes only and exclusively short-term receivables. The subdivision of this aggregate into four micro-aggregates (commercial, financial, tax and non-characteristic) is necessary to determine a series of income and financial ratios: deferred commercial liquidity substantially includes all short-term trade receivables net of the allowance for doubtful accounts; deferred financial liquidity includes all short-term financial receivables; tax-deferred liquidity includes all short-term tax and social security/assistance receivables; non-characteristic deferred liquidity consists of all future revenues (realisable within 12 months), not already included in previous aggregates, which have the characteristic of not being considered part of the company's typical operations. This is the case, for example, of receivables related to the sale of long-term assets. It is evident that this receivable cyeart be included in the typical business activity (otherwise, the receivable would be from customers). For this reason, it can be included in this sub-aggregate;

- short-term assets non-characteristic comprise all accounting items held for capital purposes such as securities/shares had with a view to their sale within the next financial year;

-Availability equivalents are the total inventories of the enterprise;

- tangible long-term assets comprise everything that will provide the company, through the start-up of the production process, with income in the long term and that, at the same time, is endowed with physicality;

- Intangible long-term assets, on the other hand, consist of everything that will provide the company with long-term income through the start of the production process, but which, at the same time, is not physical;

-long-term credit assets include only and exclusively long-term loans. The subdivision of this aggregate into four micro-aggregates (commercial, financial, tax and non-characteristic by definition) is necessary to determine a series of income and financial ratios: the long-term commercial credit asset includes all long-term trade receivables net of the allowance for doubtful accounts; the long-term financial credit asset includes all long-term financial receivables; the long-term tax credit asset includes all long-term tax and social security/welfare receivables; the long-term non-characteristic credit asset by definition consists of all future revenues (realisable beyond 12 months), not already included in previous aggregates, which have the characteristic of not being able to be considered as belonging to the company's typical operations. This is the case, for example, of receivables related to the sale of long-term assets. It is evident that, by theoretical definition, this receivable cyeart be included in the typical business activity (otherwise, the receivable would be from customers). For this reason, it can be included in this sub-aggregate;

- long-term assets comprise long-term items that identify capital investments. Examples of such things may be civil buildings and securities and participations held not for speculative purposes but as a long-term investment in the company;

- stand-alone items It should be noted that it is only in the context of the integrated information system that an element is highlighted that is, in fact, fundamental for the implementation of a correct balance sheet analysis and whose failure to be taken into account may lead to the determination of aggregates without financial significance. In addition to the aggregates indicated above, it is desirable to include a further category of items in the capital employed and in the total sources, defined as "stand-alone items", which identifies a set of items which, although they must be recognised in the reclassification for accounting balancing reasons, in reality, will not be transformed into future income or expenditure. An example of such an item is the amount of a provision for future expenses or

tax provision that, following specific elements (e.g. court decisions, tax commission decisions, etc.). However, it cyeart be eliminated from the accounts due to the principles of prudence and accrual; it can be reasonably assumed that, in the following financial year, it will be transformed, for accounting purposes, into an extraordinary item and not into a future expense or income (separate item in the assets). An example of an item that should be recognised in different entities in debt is the amount of the tax advance that exceeds the tax liability that can be offset and will be offset in the future. This amount does not identify a lower expense recognised in the financial statements (the debt has not yet been created), nor is it considered future income. For this reason, it should be recognised as a separate item in the reclassified balance sheet, an aggregate that, as noted above, is part of the concept of the net asset or net capital employed (i.e. the reclassified total assets).

-short-term financial liabilities include all financial liabilities that will result in a cash outflow within one year; short-term tax liabilities include all tax and social security/social security liabilities that will result in a cash outflow within one year; short-term non-financial liabilities include all non-tax and non-financial liabilities that will result in a cash outflow within one year;

-long-term financial liabilities include all debts of a financial nature that will result in monetary outlays beyond one year; long-term tax liabilities include all debts of a tax and social security/social security nature that will result in monetary outlays beyond one year; long-term non-financial liabilities include all debts of a non-tax and non-financial nature that will result in monetary outlays beyond one year;

-shareholders' equity is interpreted as the company's wealth that will essentially result in the company's final exit. It is only when the company is put into liquidation that equity will become a future output;

-stand-alone items: see the considerations made about stand-alone items above. Naturally, items under liabilities are found in assets: an example of such an item is the amount of advances from customers received in connection with a contract that is about to be terminated and for which no reimbursement is expected. This item will become a contingent asset the following year, and, therefore, there is and will be no monetary movement. For this reason, the item must be recognised in a separate aggregate, separate from the items that will undoubtedly become cash outflows or receipts in the future.

Basic outline of reclassified profit and loss that can be used as part of an integrated business analysis:

Charactetistic
Charactetistic Revenue **Cost of Sale**
Gross Profit
(Administrative Costs) **(Commercial Costs)** **(Research and Dev. Costs)** **(Overhead cost)**
Gross operating Profit (GOP)
Non Characteristic
Revnue from asset non charactetistic Management **(costs from** asset non charactetistic Management**)** **Financial management** **(financial management costs)** **revenues from non-characteristic activities by definition** **(rCost from non-characteristics activities by definition)**
Ante tax Profit
(Tax)
Net Profit

Characteristic

1) Characteristic Revenue: Sales Revenue

2) Cost of sale: The cost of sale, or production of the product sold, identifies all production costs incurred by the enterprise in carrying out its core business. To make a complete analysis, it is necessary to locate a sub-aggregate, the cost of the finished product, which identifies the cost incurred to finish the object of production. This cost does

not include inventories of finished goods and merchandise, just as it should not include any purchases of goods in the above aggregate.
In summary terms, the cost of sale can be summarised as follows:

Consumption of raw materials
Consumption of ancillary materials
Consumption of semi-finished goods
Production depreciation
Productive wages
Production severance pay
Other industrial costs
.....

Inventories Initial work in progress
(Final inventories of work in progress)
Inventories. Initial semi-finished products of production
(Final inventories of semi-finished products of production)

COST OF FINISHED PRODUCTS

Inventories Initial of finished products
(Closing inventories. of finished products)
Inventories Initial goods not processed but sold in the state in which they were purchased
goods not processed but sold in the state in which they were purchased
(Closing inventories of goods not processed but sold in the state in which they were purchased)

COST OF GOODS SOLD (COST OF SALE)

3) Administrative costs: Identifies all administrative costs and negative income components incurred for corporate representation purposes

4) Commercial costs: It identifies the sum of commercial, marketing and sales costs

5) Research and Dev. Costs: Identifies the sum of research and development costs incurred during the year

6) Overhead Costs: These costs identify notional values present only in companies belonging to a group. The holding company performs activities from which the subsidiaries or affiliated companies benefit free. It defines group strategy, identifies tax strategies, determines the financial management of intra-group flows, manages human resources at the senior/management level and, often, engages in institutional marketing activities. Subsidiaries or associates enjoy the benefits of these activities free of charge. The holding company does not 'pass on the costs to the companies by issuing invoices but carries out the transaction off the books for internal company purposes only.
In the presence of overhead costs in the reclassified profit and loss account, the net income for the year in the final balance sheet differs from the income in the reclassified profit and loss account by precisely the amount of the costs charged off-balance sheet. These amounts are set off the books, and thus, without impact on the subsidiary's financial statements, by parent companies. In the absence of accounting movements, these costs do not appear in the subsidiary's financial statements and therefore only represent amounts included in the reclassification to assess the performance of the subsidiary's management. Including this item allows for a better assessment of the subsidiary's characteristic performance. This company is also "loaded" with the negative income components of which, although it does not make any disbursements as the parent company bears them, it benefits from these amounts.

Non Characteristics:

1)Revnue and cost from asset non charactetistic Management
Non-capital assets are all income and expenses arising from capital investments, constituting invested capital, which is not used in the company's core business. As noted in the preceding pages, capital assets comprise two sub-aggregates, referred to as short-term assets and long-term assets, within which those balance sheet items must be ‘

included, respectively maturing within the financial year or beyond the next financial year not utilised in the company's core business.

Examples include civil buildings, securities and equity investments (please note that the above reclassifications and remarks on profit and loss reclassified to cost of sales and revenues can be applied to all non-banking and insurance companies).

If such non-characteristic balance sheet items result in revenues or if such investments require incurring costs, the negative and positive income values are to be included in the asset management of the non-characteristic business activity of the enterprise.

2) Income from financial management and financial management costs: All income and expenses arising from receivables or payables of a financial nature are to be included under financial management. These amounts consist primarily of interest income and expenses on current bank accounts or other financial debts and receivables. Following both national and international accounting standards, exchange rate gains and losses are also shown in this aggregate. This is because exchange rate activity is always considered, by the abovementioned standards, to be outside the purely typical business activity.

3) Revenues and costs from non-characteristic activities by definition: concerning non-characteristic activities by definition, it must be emphasised that the aggregate under consideration is often improperly identified with the expression "extraordinary revenues and costs". The aggregate of extraordinary expenses/income, however, does not coincide with the aggregate of non-recurring items by definition, as it is possible to identify numerous accounting values that, although ordinary, identify income items of non-recurring nature (e.g. capital gains/losses deriving from the sale of fixed assets connected to the regular replacement of assets within the production process).
The aggregate 'non-typical income and expenses by definition' must include items that, by their intrinsic nature, cyeart relate to the performance of typical activities. We mean, for example, all capital gains/losses and contingent assets and liabilities of both ordinary and extraordinary nature.

4)Taxes: tax management identifies income taxes for the year.
This item makes it possible to determine how much income tax has affected pre-tax income, i.e. calculated gross of this cost.

It should therefore include neither taxes nor property taxes in this aggregate. The former because they identify sums paid to obtain identifiable services, as opposed to taxes that are paid to be able to enjoy a range of services provided by the public entity. On the other hand, wealth taxes are not included in tax management because the requirement to be met with the identification of this aggregate is the determination of the percentage of produced income subject to taxation.

Cash flow statement template that can be used as part of an integrated business analysis

Accounting Operations With An Impact On Cash And Active Bank	**Monetary Requirements**	**Monetary Sources**
Monetary Cash Flow		
(Or Monetary Cash Flow From Core Business)		
Long-Term Management Of Tangible And Intangible Assets		
Financial Management		
Assets Non Characteritics Management		
Non Characteristics By Definition Management		
Tax Management		
Termination Benefits For Staff Management		
Management Of Non-Tax Provisions For Risks And Charges		
Equity And Dividens Management		
Δ Cash And Bank		
Total		

On a superficial reading, the above schematics might seem 'over-dimensioned' compared to the structures used by accounting analysts. The aggregations proposed within an integrated analysis scheme framework show a greater complexity than the schematisation commonly used in practice.

However, such analyticity appears indispensable for the analysis to delve into the various areas of company management in a precise, complete and exhaustive manner.

Adopting more simplified and synthetic structures would necessarily entail the 'compaction' of differentiated management elements whose aggregation would prevent a subsequent analysis of the individual parts.

For this reason, the writer believes that the use of the reclassification structures illustrated above represents the discriminating element between a financial reporting analysis that is truly useful for the accounting

investigation of balance sheet and profit and loss data (final and/or planned) and a mere in-depth analysis of such values lacking any real informative validity.

The subject of this work is an in-depth examination of so-called 'operational management."
The preceding pages emphasised that it must identify this concept in advance to avoid misunderstandings regarding its internal composition.

In an integrated financial reporting analysis context, the concept of 'operational' identifies what can be linked to the management of the company's entire capital from an equity and income perspective.

This capital includes the components intended for the company's typical management and the elements that have nothing to do with this activity. Therefore, 'operating' capital is composed of characteristic, financial, and patrimonial assets.

Everything that represents an 'investment', identifies the company's operational management. Hence, it can be understood how the capital associated with this capital concept coincides with what is referred to in the reclassification of the balance sheet as invested capital.

Investigating such management's income results requires determining an income that can be correlated with the set of characteristic, financial and asset elements. This concept of 'profit' cyeart, under any circumstances, be influenced by aspects of the liabilities as these do not form part of the 'operating' balance sheet aggregate. This is the reason why the economic result associated with this capital, which, for semantic reasons, we can call 'operating income':

- on the one hand, it must necessarily include, within it, the profit from characteristic, financial and asset management
- and, on the other hand, it cyeart, by definition, be 'contaminated' by costs related to negative debt items.

The operating income, i.e. the economic result of the invested capital, can therefore only be determined by aggregating the impact of the characteristic management, the asset management and, finally, the financial asset management.

For the reasons stated above, negative income components that can be linked to company debts (passive financial management costs) must, on the other hand, be excluded from the calculation, as these financial items do not form part of the capital to which the operating income must be inter-connected.

On the other hand, it should note that it is correct to include the costs of asset management in the concept of operating income as these, although representing negative components, are correlated to asset items included in the capital assets.

The total profit and loss scheme is, therefore as follows:

Charactetistic
Charactetistic Revenue **Cost of Sale**
Gross Profit
(Administrative Costs) **(Commercial Costs)** **(Research and Dev. Costs)** **(Overhead cost)**
Gross operating Profit (GOP)
Non Characteristic
Revnue from asset non charactetistic Management **(costs from** asset non charactetistic Management**)** **Revenue form Financial management**
Operating Profit
(financial management costs) **revenues from non-characteristic activities by definition** **(rCost from non-characteristics activities by definition)**
Ante tax Profit
(Tax)
Net Profit

3) RATIO MEASURING OPERATIONAL PROFITABILITY: THE ROA. STUDY OF THE COMPONENT PARTS OF ROA AND OF OPERATING PROFITABILITY

It is evident from the above that the economic evaluation of operations requires a comparison between operating income and invested capital. Generally, at both theoretical and technical-pragmatic levels, the acronym ROA is used to identify this profitability.

$$ROA = \frac{\text{OPERATION PROFIT}}{\text{NET ASSETS}}$$

Determining this profitability appears indispensable for the management analysis of any company. If, however, on the one hand, the identification of this information element constitutes a necessary step, on the other, ROA is not a sufficient quantitative determination.

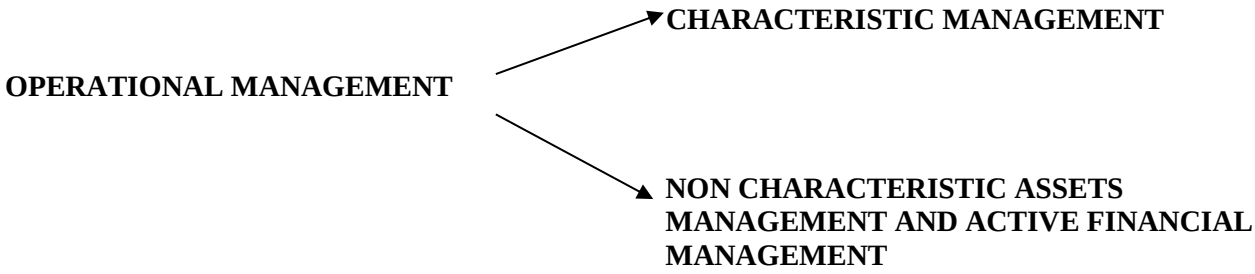
The synthesis characterising this quotient represents its main asset and its most significant' shortcoming'. The analysis of operating profitability must therefore be accompanied by a simultaneous analytical examination of the three business activities that make up this management area (core business, assets and financial assets).

Only the knowledge of the individual profitability constituting the company's operations allows the preparation of practical management actions to improve the company's overall profitability.

For theoretical/pragmatic reasons, asset and financial asset management are analysed in an aggregate manner as there is no perceived need for analytical knowledge concerning each of the two activities.

Consequently, the operating business can be considered the aggregate of the characteristics management, non characteristic assets management, and active financial management.

OPERATIONAL MANAGEMENT COMPONENTS



NON CHARACTERISTIC ASSETS MANAGEMENT AND ACTIVE FINANCIAL MANAGEMENT

The need to delve into the parts of operations makes it indispensable to identify a ratio that allows the analysis of characteristic activities.

To avoid unnecessary repetition, it should recall that this profitability, too, must, of necessity, be characterised by an intrinsic consistency between the values to be correlated.

The determination of characteristic profitability, therefore, presupposes the prior identification of two elements:

1) income related to the performance of typical operations
2) assets related to this activity.

Concerning the first mentioned value, the reclassification of profit and loss proposed above provides for the identification of GOP, which identifies the profit/loss deriving from the company's characteristic activity. Therefore, the income value necessary to determine the quotient is already provided for in the profit and loss reclassification scheme that can use within an integrated analysis system.

On the other hand, the situation concerning the balance sheet element is different. The balance sheet structure does not provide for the identification of the assets connected with the performance of the core business. However, the analytical reclassification illustrated above makes it easy to identify this aggregate.

To determine the capital invested in the core business, it is sufficient to eliminate, from the total invested capital, the aggregates unrelated to this activity's performance.

In general terms, it can say that this characteristic capital derives from the sum of the values written in capital letters:

ASSETS	**31/12/N**	**LIABILITIES AND EQUITY**	**31/12/N**
Short-Term Assets		**Short-Term Liabilities**	
Immediate liquidity 1 **Cash** Bank 2 Deferred liquidity ***** Trade receivables * Financial liquidity *Tax-deferred income * Non-characteristic deferred income 3 AVAILABILITY (INVENTORIES) 4 Short-term assets non-characeristic 5 ADVANCES TO TRADE SUPPLIERS		1 Short-term financial liabilities 2 Short-term tax liabilities 3 Short-term non-financial liabilies	
Long-Term Assets		**Long-Term Liabilities**	
1 LONG-TERM TANGIBLE ASSETS **2** LONG-TERM INTANGIBLE ASSETS **3** LONG-TERM CREDIT ASSETS * Trade Accounts Receivable * Financial assets * Tax assets * Non-typical accounts receivable **4** Long-term assets non characteristic		1 Long-term financia liabilities 2 Long-term tax liabilities 3 Long-term non financial liabilities **Equity**	
Stand-Alone Items (Only If Characteristic Itemes)		**Stand-Alone Items**	
Net Assets		**Balance Total**	

Summary of items related to core business: items written in capitals = CAPITAL INVESTED IN CORE BUSINESS (CICB)

Characteristic profitability (ROI) is thus derived from the contrast between operating income from typical operations (GOP) and capital invested in core business (CICB).

REDDITIVITA' DELLA GESTIONE CARATTERISTICA

$$\textbf{ROI= Characteristic profitability=} \frac{\textbf{GOP}}{\textbf{CICB}}$$

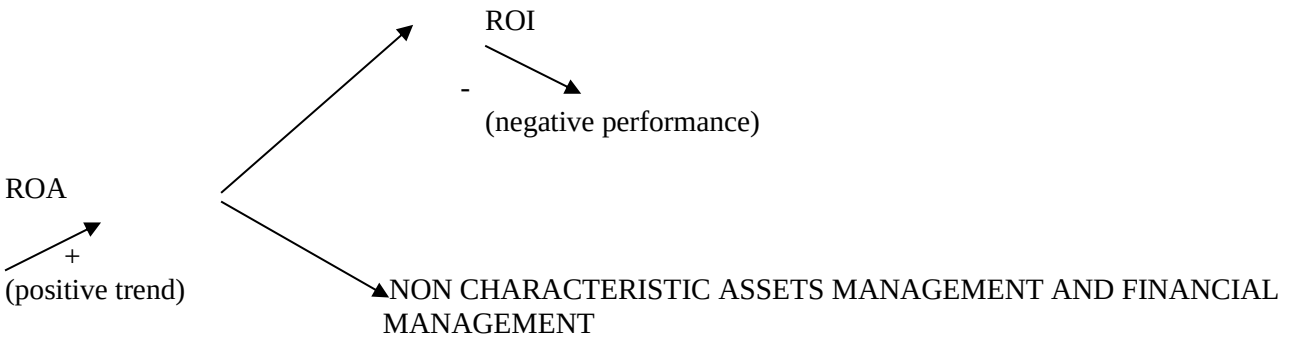
The investigation of the profitability of active asset management+financial management is generally regarded as the result of the residual inquiry concerning the performance of the core business.

Since ROA depends on the performance of three activities, it is often stated, in a simplified manner, that what ROA does not depend on ROI is, by definition, attributable to the performance of the two non-characteristic assets management+ active financial asset management.

This consideration is not wrong but can easily be misinterpreted.

In this regard, it is considered appropriate to give a simple example:

Suppose that, when comparing the results of two consecutive financial years, ROA shows an increase against a decrease in ROI.



NON CHARACTERISTIC ASSETS MANAGEMENT AND FINANCIAL MANAGEMENT

In simplified terms, it could be stated that, given the positive trend in ROA and the concomitant negative trend in ROI, active asset and financial management shows a considerable improvement in that it not only absorbed the deterioration in characteristic profitability (ROI), but also managed to achieve an improved overall operating result (ROA) in the second financial year compared to what was achieved in the first administrative period.

Such reasoning implies, however, a simplification with respect to an element that is not apparent from the above figures.

In fact, while it is true that overall profitability depends on the performance of both ROI and asset management+financial assets, it is equally true that ROA also represents the result of the weighting of assets invested in typical and non-core business respectively.

Thus, ROA is influenced not only by the performance of ROI and profitable of non characteristic asset+financial profitability, but also by the extent to which the assets are invested in the two managements.

This clarification makes it possible to better understand the concepts of 'positive performance' and/or 'negative performance' of ROI and return on non characteristic + financial assets.
Let us take the following data as an example:

RATIO	Year N	year N+1
ROA	**7,5%**	**18 %**
ROI	**10%**	**20%**

The following information can be derived from the above ratios:

- ROA increases by 140%
- ROI increases by 100%

A comparison of these figures allows the following to be argued

Operating profitability shows an increase of 140% against an increase in characteristic profitability of 100%. These values make it possible to state that, in percentage terms, operating profitability was 'better managed' than core business. A further consideration often accompanies this objective observation: it is often considered that a more than the positive performance of the active equity + financial business is evident from this comparison. The percentage increase in overall profitability exceeds that associated with the performance of the core business. Considering capital and financial assets as the primary cause of the more significant increase in ROA (compared to ROI) is a short step.

This reasoning appears characterised by a simplification that, in some cases, may lead to an incorrect interpretation of the management events under analysis.

To fully understand the performance of individual areas, it is necessary to have information on the composition of invested capital. In the absence of such data, any deduction may be misleading.

Let us assume, for example, that the ROA and ROI values indicated above are correlated with the following balance sheet and income statement:

Capital	**Year N**	**Year N+1**
Capital Invested In Core Business (Cicb)	2000	4000
Capital Not Invested In Core Business	2000	1000
Net Assets	2000	5000
Income Elements	**Year N**	**Year N+1**
Gop	200	800
Revenue And Cost Non Char. Assets And Profit Active Financial Management	100	100
Reddito Operativo	300	900
Interest Expenses	(40)	630)
Tax	(140)	(360)
Net Profit	120	480

Comparing the various elements, it is evident that ROA and ROI amount to, respectively

ROA: 7.5 % 18%.
ROI: 10% 20%.

To understand, however, the exact influence of the typical management and the active capital+financial management, it is necessary to determine the weighting of the invested capital in the two managements.
This weighting is carried out by pitting part capital against total assets.

Weighted weight of capital invested in typical operations:

$$\frac{CIGC}{CI} = \frac{2000}{4000} = 0{,}5 \text{ (year n)}$$

$$= \frac{4000}{5000} = 0{,}8 \text{ (year n+1)}$$

Peso ponderale capitale investito nella gestione non caratteristica:

$$\frac{CNICB}{NT} = \frac{2000}{4000} = 0{,}5 \text{ (year n)}$$

$$\frac{CNICB}{NT} = \frac{1000}{5000} = 0{,}2 \text{ (year n+1)}$$

It can see from the above figures that:

- the core business showed a doubling of profitability, which occurred simultaneously as the percentage of capital invested in this activity increased. Thus, not only did profitability increase, but the portion of capital placed in core business also increased

- active asset and financial management showed an equal increase in percentage profitability. Contrasting, in fact the active asset and financial income elements (net of asset costs) with the capital invested in these managements, it can see that the profitability increased from 5% to 10%. Again, there is, therefore, a perfect doubling of profitability. What must be emphasised, however, is that the weighting of the capital invested in non-core management drops dramatically. From 0.5 it drops to 0.2.

This means that the non-core business, in year n+1, despite doubling profitability, 'weighed' less than in year n.

It can understand this reasoning mathematically by disaggregating the ratio that identifies ROA. This disaggregation leads to the following formula:

$$ROA = \frac{OP}{NT} = \frac{GOP}{CICB} \cdot \frac{CICB}{NT} + \frac{\sum \text{REV./COST ASS. N.C.} + \text{FIN. REV.}}{CIGNC} \cdot \frac{CIGNC}{NT}$$

OP = OPERATING PROFIT
GOP= GROSS OPERATING PROFIT
NT = NET ASSETS
CICB =CAPITAL INVESTED IN CORE BUSINESS
CNICB= CAPITAL NOT INVESTED IN CORE BUSINESS
∑ REV./COST ASS. N.C. + FIN. REV = ∑ REVENUE AND COST FROM NON CHARACTERISTIC ASSETS MANAGEMENT +REVENUE FROM FINANCIAL MANAGEMENT

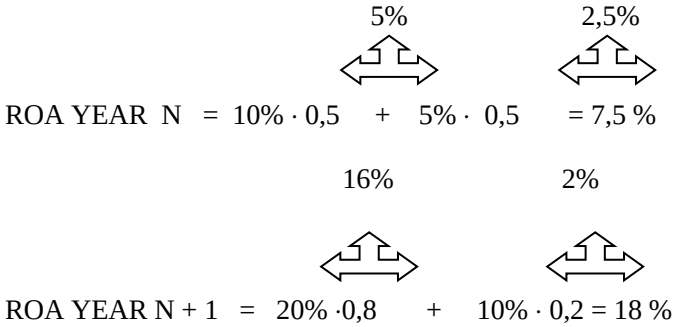
Application of the above formula leads to the following results:

ROA YEAR N = 10% · 0,5 + 5% · 0,5 = 7,5 %
ROA YEAR N + 1 = 20% ·0,8 + 10% · 0,2 = 18 %

An analysis of the data shows that, against a 140% increase in overall operating profitability, there is a 100% increase in characteristic profitability. This increase is accompanied by an improvement in the profitability of active assets and financial management, which, however, is combined with a reduction in the capital invested in these managements. Even though the increase in characteristic profitability is, therefore, equal in percentage terms to the rise in non-constitutional profitability (100%), the shift of capital from non-constitutional to typical activities has meant that, overall, the incidence of the performance of characteristic activities has weighed more heavily than that of active asset and financial management.

To state that there has been an improvement in the asset and financial asset activity (a phrase written in the 'simplified' analysis without taking into account the weighting of the capital invested in the various managements) is therefore not, in itself, wrong, but, in light of the data presented with the complete mathematical formula of the ROA, it is a 'misleading' assertion or, at least, not a complete one.

The analysis is even more comprehensive if intermediate aggregate values are determined:



From the aggregated data by area, it can see that in year n, core profitability amounted to 5%, against 2.5% related to capital and financial assets.

In the following year, the core profitability, weighted with the amount of capital invested in this area, amounted to 16%, against 2% related to active equity and financial activities. In summary terms, typical profitability increased by 100%, from 10% to 20%. In weighted terms, however, it rose from 5% to 16%. The asset and financial return on assets showed a percentage increase equal to that of typical activity (by 100%). Against this increase, however, there was a decrease in the weighting of the capital invested in these assets. In summary, the 'weighted' profitability fell from 2.5% to 2%.

From these simple values, it is clear that drawing correct, complete and exhaustive considerations are impossible without disaggregating the ROA. In the absence of such an analysis, the simple comparison between the percentage increase in operating profitability and the characteristic return may lead to deductions regarding the performance of the two areas making up the operating activity (characteristic management and asset management+financial assets), which, if not completely erroneous, may, in any case, be misleading concerning what occurred in the company's reality.

4) CONCLUSIONS

After this brief analysis of the operational performance of companies, it can point out that the issue of correctly identifying the concept of operational management is often underestimated. Frequently, the various authors dealing with this issue for granted the notions of operational management, which instead vary according to the authors dealing with this issue and, very widely, in the sphere of analysis in which the various technical terms used have profoundly different meanings if referred to the balance sheet, profit and loss, income analysis, financial analysis,

cash flow, etc. It is therefore essential if one wishes to carry out an analysis of the company's situation that provides management with helpful decision-making tools to act within the framework of an integrated information system in which there is formal and substantive consistency in the structures of the technical terms used. After accepting this fundamental principle for a complete company analysis, it is essential not to make the frequent mistake of analysing operational management by comparing ROA and ROI performance and interpreting the performance of active financial asset management as a residual. This leads to potentially erroneous results and, therefore, can make profoundly incorrect statements about the company's situation. The analysis of operational performance is more complex. It must do it with the tools that allow for the weighting of characteristic management and active financial asset management, also taking into account the assets invested in the two types of management. If operational performance is not analysed in these terms, the results obtained may lead to results that differ from the reality being analysed and thus potentially lead management to take decisions that, instead of maximising company profitability, act exactly the opposite way.

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