

NET PROFITABILITY ANALYSIS OF TRAVEL ORGANIZERS AND TRAVEL AGENCIES

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Abstract. Evaluation of financial position and operating effectiveness of a company is a relevant problem. Therefore, separate aspects of a company's activity may be measured in different approaches. **The purpose of the article** is to present the system of a pyramidal analysis of the net profitability ratio and to evaluate the net profitability of travel organizers and travel agencies.

The research object was financial statements of travel organizers and travel agencies for the period 2009–2011. **The methods** used for this purpose were analysis of academic materials, financial statements of travel organizers and travel agencies, filing of information, comparison, and summarizing.

Key words: net profitability ratio, pyramidal analysis, travel organizers, travel agencies

Introduction

Enterprises of all types during the process of their activity seek to work effectively and to earn profit. The effectiveness of enterprise activity is measured by different types of profitability alongside other activity and operating ratios (Andrew, Damitio, Schmidgall, 2007; DeFranco, Lattin, 2007; Gowthorpe, 2005; Jagels, 2007; Mackevičius, 2009). The net profitability ratio expresses the final result – evaluates all types of expenditures as well as the profit tax.

When evaluating the net profitability ratio, it is very important to estimate and assess the factors that make an impact on this ratio in order to investigate the reasons for some ratio level or its changes. For a deeper analysis of the net profitability ratio, there may be used a pyramidal analysis system which decomposes the research object – the net profitability ratio – into factors of different levels which influence its changes.

The tourism sector is one of the most important spheres of research as it is one of the most promising branches of industry in Lithuania and a good indicator of economic changes. The tourism sector includes the activity of travel organizers and travel agencies which embrace all tourism functions, forms and products, and reflect its tendencies.

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Analysis of travel organizers and travel agencies

The Lithuanian Statistics in the survey “Tourism in Lithuania” (2011) defines travel agency as a legal entity acting as a mediator in the process of selling package tours and / or individual travel services, and travel organizers are the legal entities that are engaged in activities combining the provision and selling of two or more tourism services (transport, accommodation, meals, entertainment, sightseeing) through the mediation of travel agencies or directly to a final consumer as a single product (called a package tour) for a total price (Fig. 1).

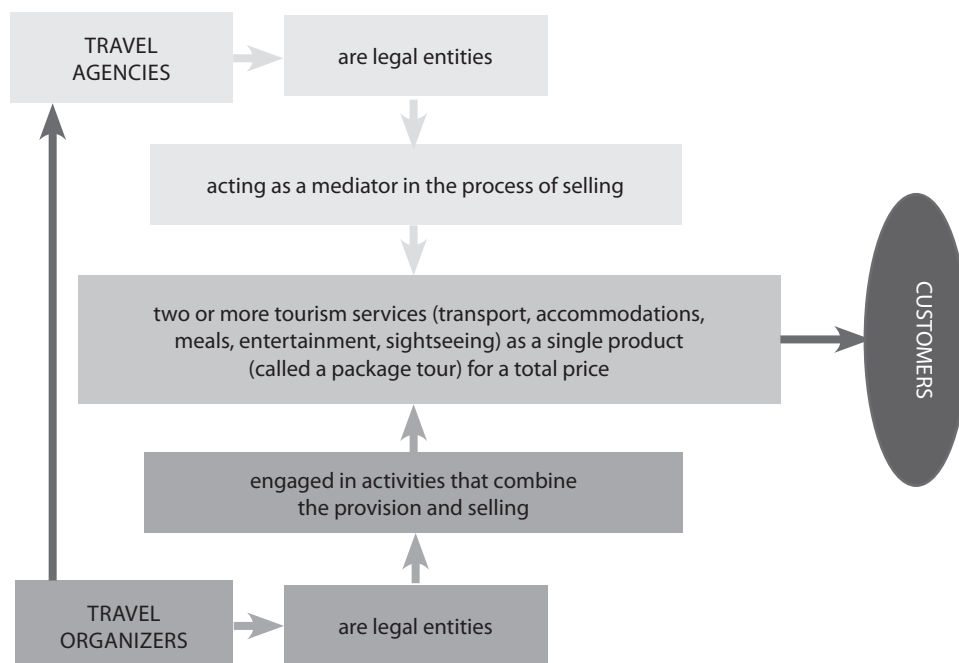


FIG. 1. Description of travel organizers and travel agencies

Source: compiled by the authors according to “Turizmas Lietuvoje” (*Tourism in Lithuania*), 2011.

The dynamics of the number of travel organizers and travel agencies and of the number of employees in these companies is presented in Fig. 2. The number of travel organizers and travel agencies increased during the period 2000–2011 more than by 20 percent, whereas the growth of the number of employees during the same period increased almost by 90 percent. This growth was influenced by the increase of the number of employees by 168 on average till 2008; in 2009 this number decreased by 10 percent and in 2010 by 2 percent under the influence of the global financial crisis. In 2011 the situation was stabilized, and the number of employees increased by almost 5

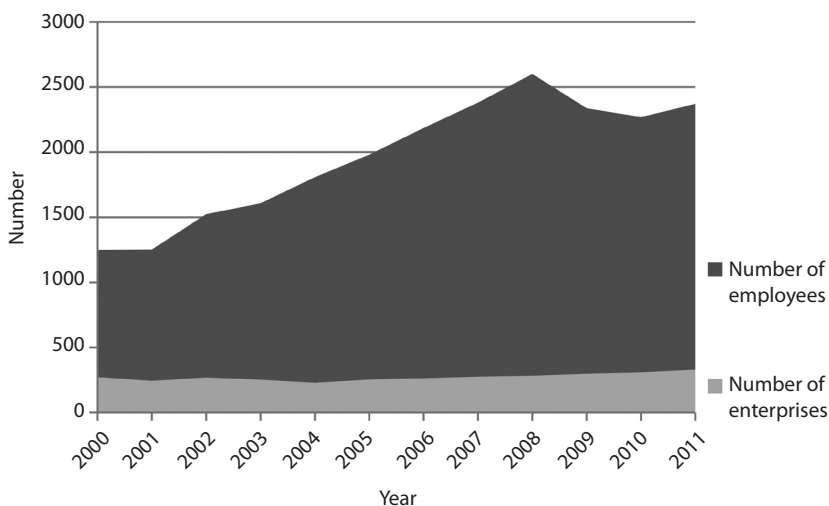


Fig. 2. Dynamics of the number of travel organizers and travel agencies and the number of employees

Source: compiled by the authors according to Database of Statistics Lithuania, 2013.

percent. The number of travel organizers and travel agencies, on the contrary, increased by 14 legal entities on average since 2005, but during the period 2000–2004 it decreased by 15 percent.

In 2011, travel agencies and travel organizers provided services for 120.3 thousand foreigners, of whom 16.2 thousand were same-day visitors, and for 193.5 thousand of Lithuanian residents, of whom 8.2 thousand were same-day visitors. As compared with 2010, the number of foreign tourists when trips were organised by travel agencies or travel organizers increased by 11.2 percent, while the number of Lithuanian residents' trips abroad decreased by 5.4 percent. Most of foreigners using the services of travel agencies or travel organizers arrived from Germany (30.3 percent), Russia (14.7 percent), Spain (6.6 percent), and Poland (5.6 percent). Lithuanians travelled mostly to Turkey (26.2 percent), Egypt (12.2 percent), Greece (8.2 percent), Spain (5.7 percent), Latvia (5.3 percent), Italy (4.5 percent), and Poland (3.3 percent) (Turizmas Lietuvoje (*Tourism in Lithuania*), 2011).

Net profitability research methodology system of travel organizers and travel agencies

The changing business conditions have a direct impact on travel organizers and travel agencies as well as on companies of different activity in cases when the analysis and forecast of business perspectives provide appropriate conditions for a proper decision making while planning the further trend of company activities. Companies whose aim is to preserve their competitiveness in the market and to maintain the continuity of

their activities have to analyze their activity results on a constant basis and to apply appropriate business analysis methods. A fair assessment of the current status allows a much more objective forecast of a company's development ways and possibilities, which is one of the essential conditions for its survival and development. The necessity of a company's activity analysis and its significance are determined by the free market economy development, constantly increasing competition, the new ways of economy management and their application, and other factors. Analysis of a company's activity is an important function of a company's management system, which is interconnected with other functions such as planning, accounting, control and regulations, and forecasting (Mackevičius, 2008).

The net profitability ratio evaluates the final result of a company's activity after the total amount of expenses or shows how much of net profit falls to sales revenue, and is the main indicator of activity effectiveness. The evaluation of the ratio only reflects fluctuation dynamics of net profitability during a period; therefore, additional ratios should be included for a deeper analysis. Their analysis establishes information relations between financial statements and other data sources. The ratios help in comparing different companies' financial statements or one company's changes during a certain period (Valentinavičius, 2012).

Although peculiarities of various companies' activity analysis have received a wide coverage, usually companies apply a ratio system which represents its activity specifics best; also, various modifications of ratio application reveal different aspects of the problem in question. The article will not go deep into the net profitability assessment principles and ratios. It will present a system of analysis of net profitability, which reveals the impact of other relative and absolute ratios and their relation to the net profitability ratio.

The authors have compiled a research methodology system, which consists of four stages (Fig. 3), for the analysis of travel organizers' and travel agencies' net profitability.

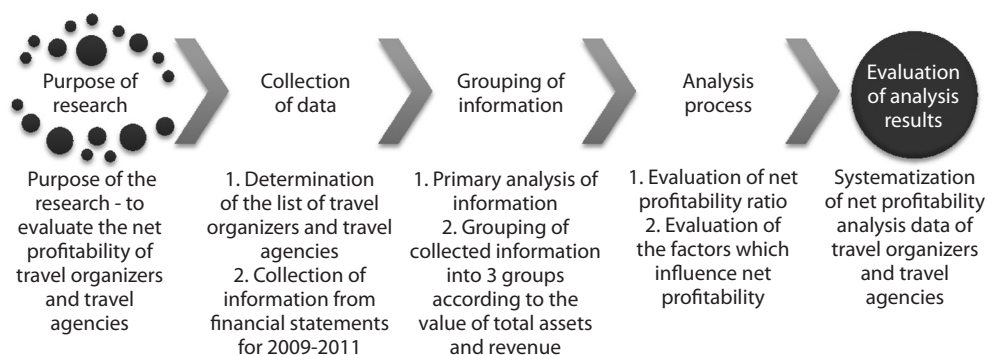


Fig. 3. Net profitability research methodology system

Source: compiled by the authors.

As shown in Fig. 3, a list of enterprises which were involved into the in economic activity “Travel agency, tour operator reservation service, and related activities” on 1 January 2012 was determined for evaluating the net profitability of travel organizers and travel agencies. The total number of companies (386) listed in this economic sector was chosen for the analysis. Information on the enterprises was collected from the *credinfo* database.

In the process of primary analysis, it has been found that all companies belong to the sector of small and medium-sized enterprises (Law on the development of small and medium-sized business, 2013). It has also been concluded that some companies (108) were not active and did not present financial statements. Therefore, for the further analysis, 278 companies were grouped, according to the criteria of revenue and total amount of assets, into medium, small, and very small (Table 1).

TABLE 1. Grouping of enterprises

| Group of enterprises | Criteria according to the Law on the development of small and medium-sized business | | Number of enterprises | Average value of revenue per group, Lt | Average value of assets per group, Lt |
|----------------------|---|-----------------|-----------------------|--|---------------------------------------|
| | Revenue, mln. Lt | Assets, mln. Lt | | | |
| Medium | 138 | 93 | 4 | 65499955 | 27221845 |
| Small | 24 | 17 | 10 | 10771584 | 3511310 |
| Very small | 7 | 5 | 264 | 770480 | 331423 |

Source: compiled by the authors.

As Table 1 shows, the biggest group consists of smallest enterprises. This group comprises 95 percent of the total number. The revenue of all the analysed enterprises makes on average 2101490 Lt and the value of assets 840039 Lt.

Their net profitability ratio was evaluated for the further analysis. The data on their net profitability ratio are presented in Table 2. They show that the biggest part of enterprises in the very small activity group was inefficient: during the period under analysis there was incurred loss, but a remarkable range of 646.37 percent indicates huge fluctuations inside the group. The net profitability of other groups did not reach 5 percent, but it was positive. The worst year was 2010 for the group of very small enterprises, 2011 for the group of small enterprises, in spite of the results of Statistical Database according to which the net profitability ratio was negative in 2009.

While assessing a company’s financial state, various means of analysis, which describe a certain area of a company’s activity, are applied; they are based on the data on the ratios in the area. In order to properly interpret the results, it is vital to assess the factors that had an impact on the ratios under analysis.

TABLE 2. Net profitability of Travel Organizers and Travel Agencies

| Group of enterprises | Average net profitability, percent | | | Variation limits by groups, percent | Net profitability of Lithuania economy, percent according to Statistical database | | |
|----------------------|------------------------------------|-------|-------|-------------------------------------|---|------|------|
| | 2009 | 2010 | 2011 | | 2009 | 2010 | 2011 |
| Medium | 0.98 | 2.50 | 1.86 | 0.06–6.39 | –4.28 | 1.91 | 3.48 |
| Small | 1.74 | 1.02 | 0.90 | –0.74–2.39 | | | |
| Very small | –3.22 | –9.24 | –1.68 | –600.75–45.62 | | | |

Each ratio highlights a certain aspect of a company's activity; however, the ratios are not entirely independent of one another: in the case of a fluctuation in one ratio value it can influence the changes in another ratio value. The Du Pont system of analysis (Buškevičūtė, Mačerniskienė 1999; Mackevičius, Poškaitė, 1998; Wilson, McHugh, 1993; Mackevičius, Subačienė, Senkus, 2012; Subačienė, Senkus, 2012) is applied to assess the interconnection of the ratios. The key principle of the system's pyramid analysis lies in the fact that the ratios are divided into multipliers which in turn are divided into comparative ratios or absolute ratio elements. The only difference is the chosen ratios.

The pyramidal analysis system, which was prepared according to the requirements of Lithuania's financial statements and is presented in Fig. 4, was compiled for the net profitability analysis.

This ratio was divided into two first level factors: return on assets, which is expressed as a fraction of net profit and assets, and assets turnover, which is a fraction of sales revenue and assets for the pyramid analysis of net profitability. Factors of the second level, which influence net profitability, are gross profit, operating expenses, the result of other activities, the result of investment and financial activity, extraordinary gains, extraordinary losses, profit tax, fixed assets, and current assets. The third level factors are sales revenue, the cost of goods sold, inventories, prepayments and contracts in progress, current receivable amounts, other current assets, cash, and cash equivalents.

A great difference among the groups is noticeable while assessing the first level factors which influence the net profitability ratio. The result of net return on assets ratio in the group of medium enterprises was quite stable and fluctuated from 0.02 to 0.03. A five times bigger ratio was found in the group of small enterprises; it made 0.16, and in the group of very small enterprises this ratio was –0.59 on average. The results of the turnover of assets ratio differences among the groups are not so dispersed: the average number during the analysed period is 10.44, but this number in 2011 was influenced by the result of very small enterprises, which was 22.57, whereas fluctuations in all groups

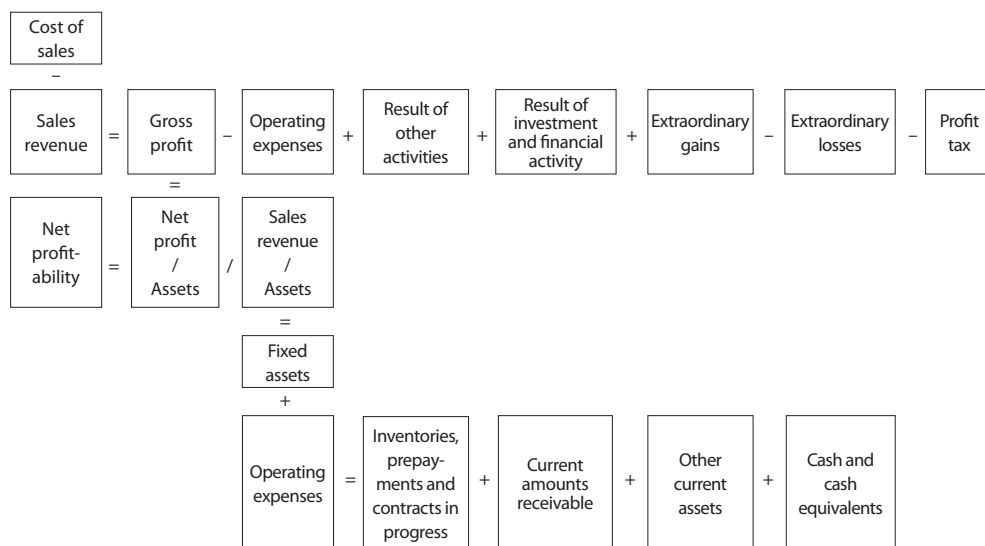


Fig. 4. **Pyramid analysis system for net profitability**

Source: compiled by the authors.

varied from 3.39 to 6.56. The total amount of assets in the group of medium enterprises during 2009–2011 decreased by almost 35 percent, in the group of small enterprises increased by 16 percent, and in the group of very small enterprises the changes of total assets were not reasonable: they increased by almost 2 percent in 2010 and decreased by the same amount in 2011. Such results may be caused by the different structure of the enterprises' group assets: in the medium group, more than 70 percent of assets are fixed assets, in the group of small enterprises their part comprises approximately 20 percent, and in very small enterprises almost 40 percent. Usually, in this kind of activity, a bigger amount of total assets comprises current assets. During the period under analysis, the structure of the current assets in very small companies was changing insignificantly and comprised for inventories, prepayments and contracts in progress about 24 percent, current amounts receivable 32 percent, other current assets 8 percent, and cash and cash equivalents about 36 percent. In the group of medium enterprises, cash and cash equivalents comprised around 2 percent, while the current amounts receivable comprised around 48 percent, other current assets 15 percent, and inventories, prepayments, and contracts in progress about 35 percent. Such a structure of current assets was quite stable and did not fluctuate by more than 3 percent, except for the year 2009 when other current assets were by 9 percentage points larger than the current account receivables. In small enterprises, the structure of current assets was different: inventories, prepayments, and contracts in progress comprised about 21 percent, current account receivables 36 percent, other current assets comprised an insignificant part of 4 percent, and cash and

cash equivalents comprised about 39 percent. Changes of the current asset structure in this group of enterprises fluctuated by 8 percentage points; there were notable changes in cash and cash equivalents and current accounts receivables in 2009 when 46 percent made cash and cash equivalents, and in 2011 when the value of current accounts receivables increased to 40 percent. More than 36 percent of cash and cash equivalents in the groups of small and very small enterprises show that the companies were more cautious in preserving part of their cash in reserves during the period under analysis, but cash and cash equivalents in the group of medium enterprises were three times bigger in absolute terms.

Sales revenue and costs of sales decreased by more than 55 percent in 2009–2010. This fact influenced the decrease of gross profit by almost 69 percent, but the decrease of operating expenses by 77 percent and the positive result of investment and financial activity may be the reason for an increase of net profitability in the group of medium enterprises. Changes in 2011 were not that significant: changes of sales revenue and costs of sales did not exceed 6 percent, and the decrease of operating expenses comprised 29 percent. In the group of small enterprises, there was a decrease of sales revenue and costs of sales accordingly by 22 and 31 percent, but operating expenses increased by 20 percent, and there were reasonable changes of other (investment, financial, and extraordinary) activities, which decreased the net profitability ratio by 41 percent in 2009–2010. In 2011, the situation was more stable: the net profitability ratio decreased by 11 percent under the influence of increased sales revenue by 26 percent, but the increase of the costs of sales by almost 32 percent and of the operating expenses by 8 percent limited the improvement trend of the situation. In the group of very small enterprises, more significant changes were observed in other (investment, and financial and extraordinary) activities. Sales revenue and costs of sales increased in 2010–2009 by 4 percent and 2011 to 2010 accordingly by 16 and 24 percent. The operating expenses decreased by 3 percent during the period under analysis, the investment and financial activity increased on average almost 5 times and other activity by 43 percent, but the results of these activities in absolute terms were not significant, and such changes did not help to reach a positive net profitability result.

Such a way of the net profitability analysis, which includes the assessment of ratios' changes in terms of time, settlement of their structure and analysis, is to be applied to travel organizers and travel agencies in their activity efficiency analysis; however, other additional ratios, which reflect the activity peculiarities of travel organizers and travel agencies, such as the accounts receivables turnover ratio, profit per employee, and the employee costs coverage ratio, may be also proposed, since accounts receivables take usually more than 30 percent in the structure of current assets, and in the economic activity of providing services, employees are a very important tool of efficiency.

Conclusions

The tourism sector is a very promising branch Lithuanian industry, to which both travel organizers and travel agencies belong; their activities also include all services (transport, accommodation, meals, entertainment, sightseeing) provided by the whole tourism sector. During 2000–2011, the number of the enterprises changed insignificantly and on average was around 274; however, the change in the number of employees in travel organizers and travel agencies was more influenced by economic fluctuations (from 1250 in 2000 to 2371 in 2011).

In order to assess the effectiveness of any kind of activity, the main ratio is net profitability, which represents the final result of a company's activity effectiveness and takes into account all losses incurred by the company. The pyramidal analysis reveals deeper aspects of analysis of the ratio, defines the factors that have an impact on its changes, and highlights the weak areas of a company's activity.

In order to assess the net profitability of travel organizers and travel agencies, the authors have analyzed all enterprises of the sector and eliminated only those which do not carry any activity and do not present financial statements. All the analysed enterprises belong to the sector of small and medium enterprises. For the purpose of the analysis, they have been divided into the medium, small, and very small enterprise groups.

Upon assessing the net profitability of travel organizers and travel agencies, it was concluded that in 2009–2011 the average net profitability of all the analysed enterprise groups was less than 5 percent, and in the group of very small enterprises the ratio was negative, even though there were significant fluctuations of the ratio inside the group. While analysing the factors that had influenced the net profitability ratio, based on the pyramidal analysis system, the structure of total assets and current assets was assessed; in the period under analysis it changed insignificantly and was quite stable, which leads to a conclusion that these factors had no major influence on the net profitability ratio. Analysis of the other factors has shown that in the group of medium enterprises, net profitability changes were caused by such factors as sales revenue, costs of sales, and operating expenses. In the group of small enterprises, sales revenue, costs of sales, and operating expenses made an impact on the net profitability ratio, but the influence of these factors was not so reasonable; besides, other (investment and financial and extraordinary) activities also influenced changes of the net profitability ratio in the group of very small enterprises. The general tendency of a more stable situation was noted in the year 2011.

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