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POSSIBILITIES OF USING METHOD EVALUATION OF COMPANIES HARRY POLLAK IN PRACTICE

Abstract:

This article focuses on the issue in a comprehensive evaluation of company using benchmarking methods. Evaluation by benchmarking techniques is based on non-financial indicators, which should be predict future potential company and evaluate its performance. One of these methods describes Harry Pollak, where it focused on viability. This method characterizes the ten criteria for evaluating of healthy business (financial result, financial satisfaction of participants, satisfied customers, products corresponding to the market, market research focused on progress, training and motivating employees, capital base, reliable suppliers, convenient localization business , relationship with the environment) eight of given characteristics is located in the outer area. This article aims to correct the model Harry Pollak, so as to enhance its objectivity.

Keywords:

Comprehensive evaluation of company, benchmarking methods, non-financial indicators, Harry Pollak, viability.

Introduction

There is a large number of ways to assess a business. However, the most important thing is the reason of the assessment and the purpose the evaluation will be used for. The assessment methods for businesses are increasingly important whether they relate to the company itself and the management needs or to the owners of the business. The management of these businesses is interested in the current situation of a business so that they pursue the values achieved and it is important for these owners to know whether the company they have founded will grow and evaluate the funds (or resources) they put in the company. It is also possible to evaluate a company for the purpose of its resale or for external parties, such as the suppliers, customers, banks, insurance companies etc.. Each of these assessments predicts a future development of the analysed company and its ability to survive for any purpose.

The current methods of assessment of a business are mainly mainly through financial analysis, but their informative value from the financial aspect is not sufficient. The company should view its own evaluation from a broader perspective than just from the accounting data. This is enabled by benchmarking models, which essentially deal with the fact of whether a company can build its competitiveness and vitality in the particular field of business. Business potential is dependent upon the management of a company and its decisions, as well as its evaluation, through benchmarking methods, will always depend directly on the actual evaluator and his or her point of view.

One of these methods is the Harry Pollak Method. It deals with a specific evaluation of viability of a business, but its disadvantage is insufficient evaluation of financial performance.

The aim of this article is to modify the Harry Pollak Model so that it enhances its objectivity. The correction of the financial performance will be compiled especially for the assessment of industrial businesses.

The Methods of Comprehensive Evaluation of Businesses

Vochozka (2011) states that the comprehensive evaluation of a business consists of a number of methods which attempt to describe the financial situation of a business. The basic classification comprises a one-dimensional analysis, risk index models, multiple discriminant analysis and models of conditional probabilities. One-dimensional analysis is based on the financial ratios evaluating the individual signals of decline. The risk index models represent a method of rating, ranking and prioritising signals. The greater score means that it has a higher importance, which is reflected by assigning weight to each criterion. Multiple discriminant analysis uses multiple statistical analyses in accordance with the issue of predicting the possible failure of a business. Models of conditional probabilities deal with less demanding statistical techniques, such as logit analysis, probit analysis and linear probability models.

The Financial Standing Models and Bankruptcy Models

Financial standing models and bankruptcy models serve as models of determining the creditworthiness of companies. They are also used by banking institutions that take a risk in providing loans. As Kotěšovcová et al. (2014) say, bankruptcy models are suited more to the situation where becoming bankrupt is common, where there actually is a bankruptcy. To the contrary, financial standing models assess the rating of a company.

Financial standing models include, for example, the creditworthiness index and the creditworthiness score. These models comprise a wide variety of different ways which are used to evaluate financial health of the company, whether it is bad or good. By contrast, the bankruptcy models and their evaluation consist of the discovery of the probability of bankruptcy. The best known models are the Altman´s index, the Neumaiers´ IN indexes, the Tafler´s model and the Beaver´s model. Another group of models comprises the so-called bankruptcy credibility models that combine both approaches (Kralicek´s Quick Test, Tamari´s model, Grünwald´s model)

Economic Value Added (EVA)

Another financial analysis method is one that businesses use in management and business valuation. Economic value added deals with the rate of return measurement. Its basic principle is the measurement of economic gain. According to Mařík (2011), the economic gain is achieved when current costs and the cost of capital are paid, including the cost of equity, unlike the accounting gain. Therefore the economic gain creates the value for the owner (shareholder value). Knápková et al. (2014) states that the main advantage of this indicator is that it helps managers improve their operational, financial and investment decisions.

Schmallenbach´s Method

This method consists of a system of indicators (the analysis of the asset and the financial situation and the yield analysis) which has the aim of improving the internal management of a company. The analysis of the assets and the financial position include the following indicators: the intensity of use of tangible assets, the turnover indicators, the debt dynamics, the equity ratio and the internal financing. The yield analysis includes the indicators such as the return on sales, the return on the assets, the equity return, the indicators of cost and the revenue structure.

Benchmarking Methods

The basis of these methods lies in recognizing the position of a business on the market when it is compared to the position of its competitors.The business identifies its strengths and weaknesses through various methods and also by the observation of its competitors; it tries to find the best practice procedure to improve the weak processes within the organization. As an example, some of these methods will be mentioned, such as the INFA Method (the assessment of mutually interconnected financial indicators), which enable one to obtain the signals of strengths and weaknesses of a company. Another example is the Balanced Scorecard Method that focuses on four sets of questions (the customer´s view, the internal perspective, the future growth and the financial perspective). The last method to deal with in this paper is the Harry Pollak Method.

The Harry Pollak Method

The Harry Pollak Method (2003) comprises ten criteria for the evaluation of a healthy company. Each company can be assigned a maximum number of points in a single criterion: market research focused on progress (13 points), which is the most important factor for the future of the company, the products market match (12 points), that is another important factor in addition to the positive characteristics of the enterprise, the satisfied customers (11 points), that is evidence of proper marketing and employees´ motivation, the satisfaction of all financial participants (11 points), that is a guarantee of future financial transactions, the environmental policy (11 points), that means preventing possible conflicts in the future, the capital base (10 points), that is a sound basis for the business, the favourable location of the enterprise (9 points), that give a competitive advantage, employees (8 points), who present a significant boon for the future of the company, the financial results (8 points), as evidence of proper company policy and finally the reliable suppliers (7 points), that are an important factor in industry breakdown.

The criteria for the evaluation comprise the significant parameters of subjective assessment:

- Market research focused on progress: monitoring the development in developed countries, extrapolation of trends with regard to the local conditions, freedom in the development of new products and the appreciation of the achievements, the appreciation of the maturity of the products and services, the research and monitoring alternatives for mature products and services, as well as the stagnation.
- The products market match: the market research initiative, the short gestation of new products/ services, the flexibility of the offer, the reorders, the use of patents and licences in the case of stagnation.
- Customer satisfaction: the continuous sales growth, the quality and services that match expectations, no complaints, the continuous interaction with customers, the intensive marketing activity, customer focus: advertising, publicity, the lack of interaction with the customers, the deadlock sales program, not to mention frequent complaints.
- The satisfaction of the financial participants: financial benefits for the shareholders, all financial claims paid, all commitments met, the use of the credit from the suppliers, the loan to bridge liquidity, factoring, as well as leasing.
- The relationship between business activities and the environment: no restrictive regulations against the company activities, the involvement in local institutions, the commitment to preventing the threats to the environment, the participation in programs to reduce energy waste, the reduction of vapours into the atmosphere, noise pollution in the neighbourhood, the willingness to help one’s neighbours, the focus on the activity of the company
- The capital base: no debts, a healthy ratio of equity capital to foreign investment, investment through the revenues, sufficient operating reserves (risk to the customers), hidden reserves (inventory valuation), depreciation, reasonable investment
- A favourable location of the enterprise: close to the market, close to the main suppliers, good and reliable roads, train and air connections, social peace, good cooperation with local institutions and trade unions, tax and other political considerations, no employee poaching
- The criteria for employee evaluation: determining the responsibilities and powers based on a precise description of the position, a strict selection of employees, training sessions focused on job performance, training sessions focused on the improvement of the skills required, educational residencies in

other companies, benefits (promotion) based on good performance, passing the information to the employees, optimal age structure, working time length, minimal employment fluctuation
- The financial results: 15% + cash flow, a break-even point, stagnation, the risk of a severely burdened business venture, an enterprise unworthy of credit, an insolvent company
- Reliable suppliers: those suppliers that are responsible for the quality, timely and quality deliveries, the willingness and close cooperation in matters of technological development and price development of the supplies, the reliability and the guarantee of future supplies, a prepaid option or the possibility of payment in a shorter period of time based on cash discounts, a possible selection of suppliers. (Pollak, 2003)

The evaluation of the individual criteria is an indicator of the business vitality expressed as a percentage share where:

- 81% - 100% : vitality is almost guaranteed
- 61% - 80%: vitality is highly probable
- 41% - 60% : vitality without intervention is not probable
- 21% - 40%: “sick” industry
- 0% - 20%: business crisis (Pollak, 2003)

Harry Pollak (2003) applied this method only to six companies and that significantly affects the evaluation of the efficiency of this method in terms of its statistics. Four of the companies that were rehabilitated by this method continue to operate in the market. The evaluation is largely dependent on the experience of the evaluator; the information which the evaluator works with can be misleading.

Methods and Data

The following indicators were selected to evaluate the financial performance. They were based on the evaluation of the future development of the company, both from the financial and liquidity points of view:

The Financial Report: it is one of the most important indicators for a company evaluation, if the company makes a profit, implying the positive earnings, it is the best way to survive in the marketplace and growth. Profit is the primary evaluator success.

- The Cash Flow: it is another important indicator for a company evaluation, as it reflects the real terms of money (the actual revenues and expenditures),
- The Pay-out Ratio: it creates a figure for the shareholders and their investment returns,
- The Current (Liquidity) Ratio: it assesses the solvency to meet its liabilities.

The Financial Performance

The financial performance score will be evaluated by four indicators, see Table 1. In order to evaluate the first two indicators due to the size of individual companies, they were divided by the turnover that the company produces. The first evaluation indicator

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is the profit which is the basis for the future of the whole company. The second indicator will follow the previous one, i.e. if the first indicator reads profit / turnover of 0.1 and the second indicator reads cash flow / turnover of 0.08, the score will be 7 points. Then, the financial performance include the payout ratio which indicates how much will be paid out to creditors on their dividends in the event that the company will pay dividends of 32%, the firm will no longer be evaluated by 7 points, but falls to 6 points. The last indicator is the current ratio, if the company reported 1.4, then the score will be reduced to 5 points. The scoring, which takes place gradually, as shown in the example, may always reduce the previous evaluation only on the line below.

Tabulka 1 Financial performance

The Scores	$\frac{\text{Profit}}{\text{Turnover}}$	$\frac{\text{Cash Flow}}{\text{Turnover}}$	Payout Ratio	Current Ratio
8	0,1 >	0,1 >	40 % >	2,6
7	0,08 – 0,09	0,08 – 0,09	35 % – 39 %	
6	0,06 – 0,07	0,06 – 0,07	30 % – 34 %	1,6 – 2,5
5	0,04 – 0,05	0,04 – 0,05	25 % – 29 %	
4	0,02 – 0,03	0,02 – 0,03	20 % – 24 %	
3	0,009 – 0,01	0,009 – 0,01	15 % – 19 %	
2	0,007 – 0,008	0,007 – 0,008	10 % – 14%	1 – 1,5
1	0,005 – 0,006	0,005 – 0,006	5 % – 9 %	
0	< 0,004	< 0,004	< 5 %	< 1

The source: modified according to Pollak (2003)

Kislingerová (2010) states that the income statement informs about a company´s success, i.e. about the performance the company achieved in its business activities. It shows the relationship between the company´s revenue in a given period and the costs associated with its establishmwnr regardless of whether their encashment occurred. This clearly shows that the cost and revenue items are not supported by the actual cash flows; thus the resulting net profit does not reflect the actual net cash acquired through the company´s economic activities.

According to Mařík (2011), the company´s accounting policy is strongly reflected in the financial reports. The inventory valuation is directly dependent upon the income in the respective years. What is important for the valuators to find out is how the financial reports are manipulated and to what extent they reflect the actual development.

According to Synek (2007), the profit performs the following important functions:

- it is the basic criterion that determines all of the fundamental issues of the economics of a company,
- it is the main source of accumulation,
- it is the basis of the income distribution between owners, investors and the state,
- it is the basic motive of any business and can be the basis of the material incentives for the workers.

It was absolutely unequivocal to include the financial performance the financial report in the evaluation, which is absolutely necessary for evaluating the company´s prosperity and its future development. Due to the potential manipulation of this financial statement, it is necessary to use a more reliable indicator of the financial ratios and profitability, which is the cash flow.

Sedláček (2005) says the cash flow accurately determines the actual movement of company funds, within a certain period of time. It is the basis for liquidity management since:

- a difference exists between the motion of material resources and their financial statement,
- there is a timing mismatch between economic operations,
- there is a differential between the yields, the revenues and the costs and expenses.

According to Synek (2007), it is a duty of the financial management to not only ensure profit-making, but especially have a sufficient amount of cash funds to pay its maturing liabilities. If not, the company becomes insolvent and thereby faces bankruptcy or a judicial settlement.

Since it was necessary to capture the size of the company, see the methods and the data (the evaluation of the profit indicator, the evaluation of cash flow indicator), transferring to a ratio that is necessary in order to express what effect has been achieved out of the company´s turnover, how the company stands in terms of the costs and revenues (profit) and the actual income and expenditures incurred on its activities. The other evaluations such as the payout ratio and the current ratio, are based on these indicators.

The payout ratio gives the proportion of the earnings that is paid in the form of dividends to the shareholders. It expresses the percentage of the dividends paid per share of the net profit per share. That is how a large a share of the net profits is distributed to the shareholders and how much the company puts into refinancing. Each sector has its own specifics, but by using this indicator the investors can verify the return on the investments. The payment of 40% or more of the total earnings per share is relatively very good, but the company must consider whether its future and growth would not be endangered, in terms of refinancing higher values.

The last indicator of the financial performance is liquidity. Kislingerová (2010) argues that if a company wants to exist in the long term, it must not only be reasonably cost-effective, profitable, but it must also be able to pay its liabilities. The liquidity is an essential part of a company´s long-term existence. The current ratio determines how many times the current assets cover the current liabilities and whether the company is able to satisfy its creditors. The fundamental purpose of the liquidity indicator is the payment of the current liabilities out of the corresponding items of assets.

Synek (2007) states that the current ratio is a relatively rough indicator of solvency, but due to its simplicity is widely used in practice, where the acceptable recommended range value is 1.5 - 2.5. Too high a value of current assets reduces company´s profitability.

Basically, it depends on the company´s approach and its strategy, as Kislingerová (2010) states; the strategy of a conservative approach has a value higher than 2.5, with the aggressive strategy she states a value lower than 1.6, but it should be no less than 1.

Conclusion

The aim of the article was to modify the method of Harry Pollak in order to enhance its objectivity. The adjustment to the financial evaluation has managed to revise this method that will have a higher informative capability in terms of the company´s sustainability.

It is thus clear how to evaluate the sustainability of individual companies. The profitability indicator ensures the company with a greater inflow of money into its assets and will ensure the growth of the company as a whole. However, the prerequisite of good future (only in terms of profitability) is not enough. The next important step is whether the particular revenues, which the company reported in its accounts, have a predictive value in cash-flow as well. If the company does not have enough money to pay its liabilities, there is a risk of insolvency and a threat to the company´s stability. The company must monitor its cash flow statement because it expresses the actual movement of funds in the reference period as the profit. The figure for the shareholders and their dividend payout ratio they receive is also important. And lastly, the company´s liquidity, from the perspective of its creditors, is for the long-term existence.

Adjusting the Harry Pollak Method for the Czech Republic will have a better predictive value for a company´s vitality due to the inclusion of the entirely new financial indicators, through which one can achieve a greater objectivity in evaluating a healthy business, especially in terms of cash management. There will still prevail certain personality evaluators in the evaluation, which will be based on the experience of the evaluator, but it is unavoidable in any of the evaluation. It is very important for a healthy company to follow the external environment as a very important part of the evaluation, as well as its financial development. The score evaluation of company´s vitality is suitable, even after these minor changes and it will remain in the same percentage terms.

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