



Evaluation of financial situation of Slovak businesses after 2020

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Abstract: The aim of the article is to evaluate the financial situation of businesses in the Slovak Republic after 2020 through selected economic indicators. We focus on small and medium - sized enterprises. We used available secondary data to characterize the development of basic economic indicators describing the economic situation of businesses. Moreover, we surveyed whether the businesses managed to cope with the increased inflation. According to our findings, the unfavourable economic situation caused by the pandemic had a negative impact on the creation of added value in the business sector in 2020. In 2021, there was a revival of economic activity, which was reflected in the increased creation of added value, as well as in the positive development of other economic indicators. As for the impact of inflation, businesses were on average able to transfer rising costs into sales.

Keywords: business, financial situation, inflation

JEL classification: E31, G32

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Ocena finančne stabilnosti slovaških podjetij po letu 2020

Povzetek: Namen prispevka je ovrednotiti preteklost in izvesti simulacijo možnega prihodnjega razvoja finančnega položaja podjetij v okolju povišane inflacije in negotovosti v Slovaški republiki. Prvič, na podlagi razpoložljivih statističnih podatkov izpostavljam o ugotovitev, da so podjetja v povprečju uspela prenesti naraščajoče stroške v prodajne cene. Nato izvedemo simulacijo prihodnjega razvoja na podlagi dveh scenarijev. Simuliramo predvsem dve vrsti šokov - rast stroškov in upad povpraševanja. Na podlagi ugotovitev sklepamo, da lahko silovito in neenakomerno zvišanje cen negativno vpliva na nekatera podjetja in poruši strukturo poslovnega sektorja. Kot smo dokumentirali, je vpliv inflacije na podjetja heterogen. V skladu z omenjenim, priporočamo spremljanje cen surovin in vložkov na svetovnih trgih, ki so pomembni za podjetje. Njihov razvoj se bo z zamudo prenesel tudi na cene na Slovaškem. Poslovodstvo mora doseči samozadostnost v taki meri, da se lahko v njegovih odločitvah odražajo domneve o prihodnjem razvoju makroekonomskih motenj. V nadaljevanju jih je treba oceniti v širšem kontekstu, tj. sprejeti prilagoditve pravnega in davčnega sistema s strani države itd.

Ključne besede: inflacija, poslovanje, finančna stabilnost

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1 Introduction

For more than two years, financial situation of businesses has mainly been influenced by disruptions from the external environment. After coronavirus crisis we have been facing since March 2020, there are new challenges with a significant impact on the global economic environment. This mainly concerns disrupted supplier-customer relations and an increased level of inflation, including rapid price growth energy and other commodities, which is also linked to the tightening of monetary policy. The negative effects of these factors are accentuated by the war in Ukraine, which is a source of considerable uncertainty regarding the future development (Figure 1).

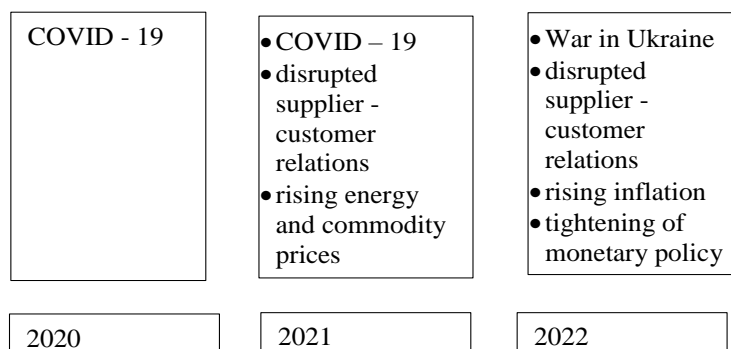


Figure 1. External factors influencing the financial situation of the businesses
Source: Own elaboration

Considering these factors, we can observe the deterioration of the performance of the Slovak economy. As shown in Figure 2, after years of continuous growth, the performance of the Slovak economy decreased.

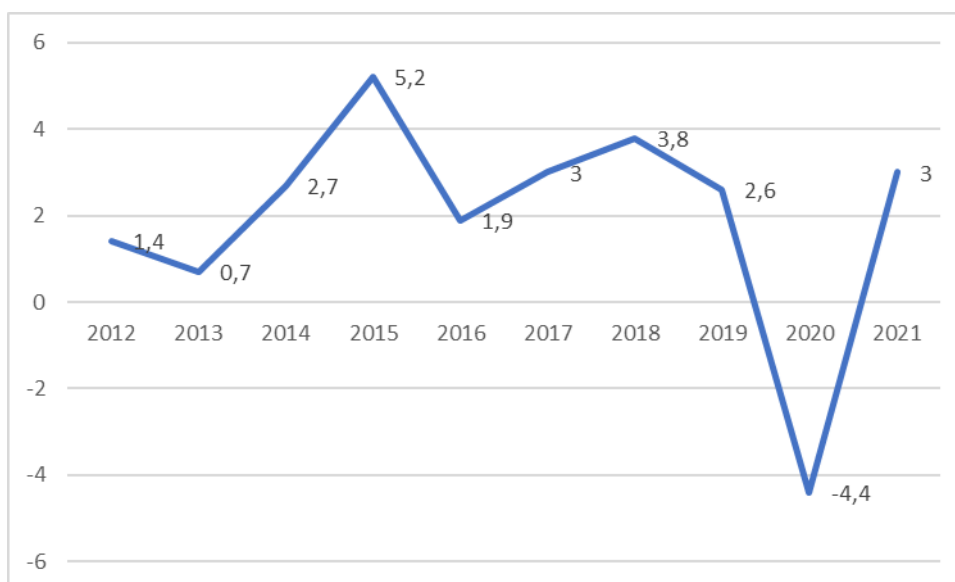


Figure 2. Real GDP growth (annual, in %) in the SR
Source: Own elaboration according to the Statistical Office of the SR

Although a slowdown in economic growth was already noted in 2019, this was more related to standard cyclical and structural changes - and had nothing to do with the coming depression (and the pandemic that caused it).

According to Business Environment Monitoring (2021), before the outbreak of the COVID-19 pandemic, the aggregated financial results and the values of financial ratio indicators of small and medium - sized enterprises (SMEs), improved in most cases. SMEs recorded a year-on-year increase in the volume of sales, net profit, property, equity and added value.

We focus primarily on small and medium - sized enterprises in our analysis. According SBA (2022), SMEs accounted for 99.9% of the total number of business entities in the Slovak economy. They account for almost two-thirds of employment in the corporate economy and contribute by more than half to the total added value.

Increased inflation had a significant impact on the economic situation of SMEs in 2022.

Inflation affects the business in many ways and its impact is reflected in the overall operation and life of the business. It has the most significant effect on changes in the prices of inputs and outputs, while these changes are generally uneven. The higher the inflation rate, the more intense and faster the changes.

As documented by Figure 3, inflation has been low since 2013, max. 3%. Between 2014 and 2016, prices even fell. The coronavirus crisis brought the lowest inflation in the last 3 years.

However, since January 2021, inflation has been growing year-on-year without a break and with a value of 15.4% for November and the same for December 2022, it has reached the highest values since the beginning of the millennium. Long-term rising food prices and housing costs, including electricity, gas and other fuels, have the most significant impact on overall inflation. These are the two most important items in household expenses, together they make up almost half of the expenses.

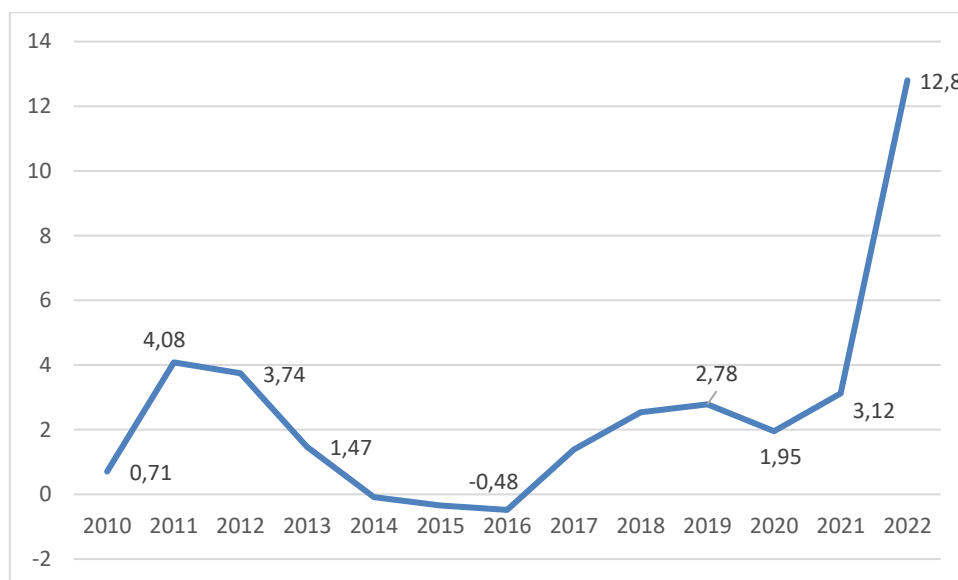


Figure 3. Development of average annual inflation (in %) in the SR
Source: Own elaboration according to the Statistical Office of the SR
Note: According to the methodology used in the SR

Inflationary pressures are on the rise practically all over the world. It was not only the eurozone, but also most of other regions and countries that entered the year 2022 with increased inflation.

Eurozone annual inflation was down to 9.2 % year-on-year in December 2022 from 10.1 % in November, which represented the first slight contraction in prices since June 2021. Though the data are undoubtedly positive, inflation in Europe remains much higher than the European Central Bank (ECB)'s target of keeping the eurozone area below 2 %.

Explanations of high inflationary pressures, which can be found in literature, are almost the same. As Elbahnasawy and Ellis (2022) argue, one of the main reasons for the increase in inflation is the increasing demand for natural resources. Similarly, Krugman (2022) states that a surge in oil and food prices will raise an inflation rate that is already too high. World Bank (2022), resp. ECB (2022) also determine higher commodity prices, resp. higher energy prices as the main reasons of high inflation. Prohorovs (2022) notes that the increase in inflation in 2021 and 2022 has mainly been due to an increase in demand and, accordingly, an increase in energy prices. The main factors that can influence the persistence of high inflation, or even its increase, include shocks in the price and supply of energy and other commodities and basic goods. The inflation rate in the EU and a number of other countries may remain high for several years or more and be a significant threat both to the economies of the countries and to businesses.

Moreover, for policymakers, entrepreneurs, and companies, it is important when planning to know not only the current inflation rate, but also what it might be in the near future. National Bank of Slovakia forecasts the annual average inflation for 2022 of around 12%. Average inflation should reach 10% next year. In 2024, average inflation should be somewhere around 9% (Forbes, 2022).

The war in Ukraine has exacerbated the dilemma faced by central banks on both sides of the Atlantic, namely, how to tighten financial conditions quickly and intensively in an environment of inflation that can no longer be seen as simply temporary and reversible, and at the same time not reduce the pace of economic activity and not provoke financial turmoil (Canuto 2022).

The aim of the article is to evaluate the financial situation of businesses in the Slovak Republic after 2020 through selected economic indicators.

Following the aim, we formulated three hypotheses:

1. we expect that the unfavorable economic situation in 2020 in Slovakia affected the development of the monitored economic indicators of SMEs.
2. we expect that, due to the revival of economic activity, the economic indicators of SMEs have improved in 2021.
3. we expect that SMEs managed to cope with the increased inflation in 2022.

We formulated the hypotheses according to the development of macroeconomic indicators, namely the GDP growth rate in % after 2020 and the inflation rate.

2 Methodology

We used available secondary data to characterize the development of the basic economic indicators describing the economic situation of businesses.

By comparing changes in prices in the production sphere with changes in sales of selected branches of the national economy of the Slovak Republic, we survey how companies managed to cope with the effects of inflation.

Added value is one of the most important quantitative indicators through which the performance of the small and medium-sized enterprises sector is evaluated. The unfavorable economic situation caused by the pandemic had a negative impact on the creation of added value in the business sector in 2020. In 2021, there was a revival of economic activity, which was also reflected in the creation of added value, as well as in the positive development of other economic indicators.

3 Results

As Figure 4 shows, in 2020 there was a suspension of the continuous growth trend of the added value of small and medium-sized enterprises, which had persisted since 2014. The added value of SMEs - legal persons (LP) decreased by 3.8% year-on-year. However, the decrease achieved was more than half lower than in the crisis year of 2009 (by 9.8%). The negative consequences of the pandemic were reflected in the results of all size categories of SMEs. Only large enterprises managed to maintain the growth of added value this year as well. Small businesses recorded the most significant slump in the creation of added value. Industry remains the most important sector from the point of view of creation of added value of SMEs. In 2020, industry accounted for one quarter (25.0%) of the total added value of SMEs - LP. The second most important sector is trade, which in 2020 accounted for more than one fifth (22.1%) of the created added value of SMEs. The three most important industries are completed by business services with a similar share as trade (21.4%).

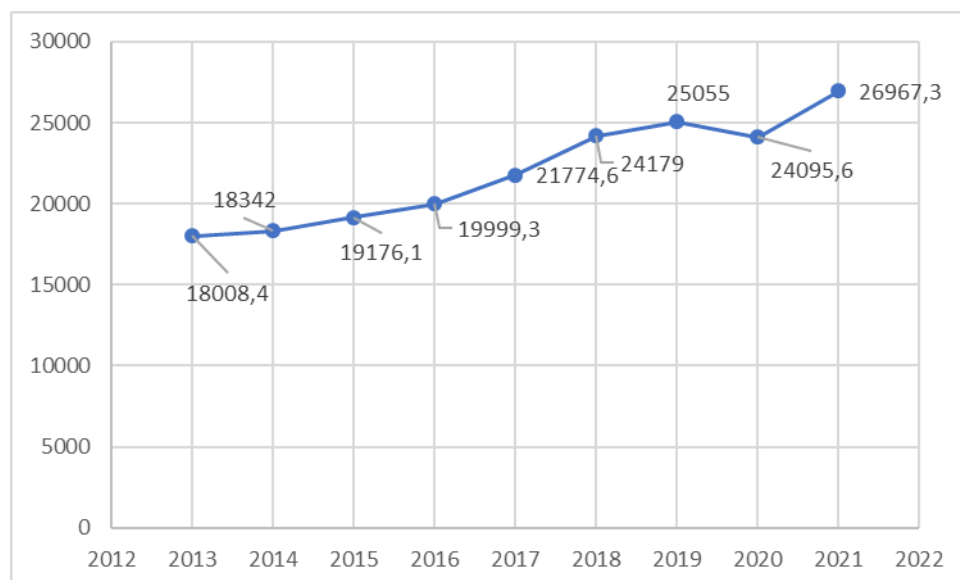


Figure 4. Development of added value (in eur million)
Source: Own elaboration according to the Statistical Office of the SR

In a year-on-year comparison, other economic indicators of SMEs also decreased. The gross production of SMEs - LP decreased by 4.8% year-on-year. The investment activity of small and medium-sized enterprises also recorded a negative development. The creation of gross fixed capital of SMEs decreased by 13.6%. Profit before taxation of SMEs - LP decreased by 11.8% year-on-year.

It is also possible to assess the profitability of small and medium-sized entrepreneurs through the indicator of the share of SMEs with a positive economic result, which is

presented in Figure 5. In Slovakia, almost two-thirds (64.5%) of small and medium-sized enterprises achieve a positive economic result (including a zero economic result). In a year-on-year comparison, the share of the listed entities decreased, mainly due to the negative effects of the corona crisis.

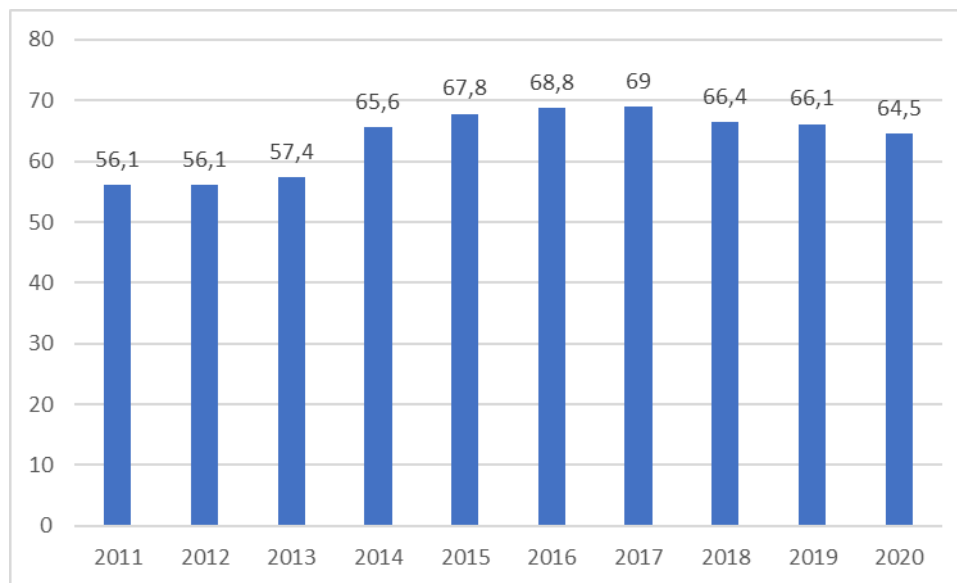


Figure 5. Share of SMEs with a positive economic result (in %)
Source: Own elaboration according to the Statistical Office of the SR

In 2021, due to the moderate recovery of economic activity, the added value of SMEs - LP increased by 11.9% in current prices in all sectors of the economy. The added value of SMEs increased most significantly in the trade, other services, transport, information activities and industry sectors. Added value also grew in accommodation and catering, but the achieved growth of 5.7% could not compensate for the drop of 15.4% from 2020. Positive development was recorded by all size categories of SMEs. The most significant growth in the creation of added value was achieved by small enterprises.

In 2021, the share of SMEs - LP reached 54.9% in the created added value in the non-financial corporate sector. In a year-on-year comparison, the achieved share of SMEs increased. At the same time, it reached the same value as in 2019 (i.e. in the pre-pandemic period).

Other economic indicators of SMEs also recorded a positive development. The gross production of SMEs increased by 12.3%. The creation of gross fixed capital of SMEs, which shows the state of investment activity, increased by 7.2%. An increase of 34.8% was recorded in the creation of the gross profit of SMEs, which increased after the previous two-year decline.

Increased inflation had a significant impact on the economic situation of SMEs in 2022. Inflation affects the business in many ways and its impact is reflected in the overall operation and life of the business. It has the most significant effect on changes in the prices of inputs and outputs, while these changes are generally uneven. The higher the inflation rate, the more intense and faster the changes.

As Figure 6 shows, the prices of several commodities and goods grew dynamically during the entire year 2022. The most significant year-on-year price growth is present in energy commodities.

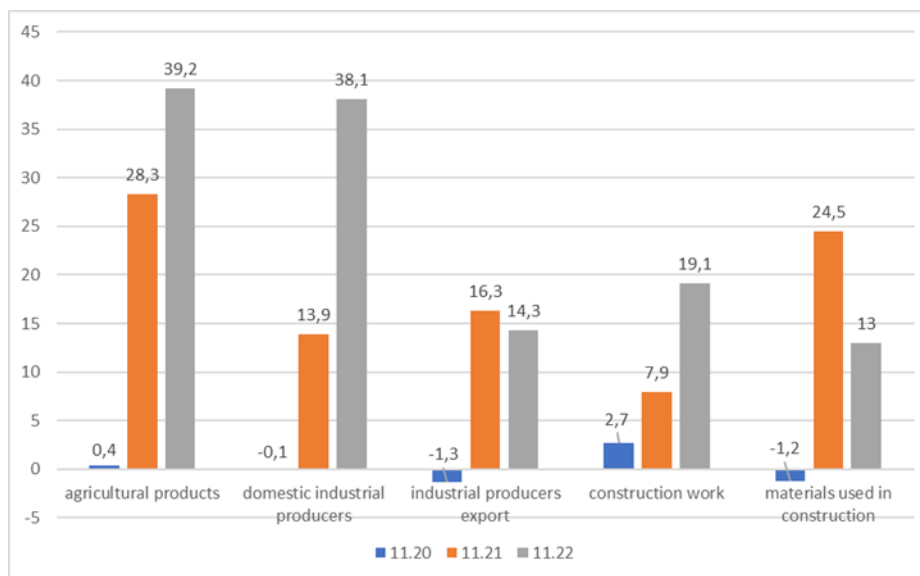


Figure 6. Price change in the production sector (year - on - year in %)
Source: Own elaboration according to the Statistical Office of the SR

According to Figure 7, November sales grew year-on-year in three of the five monitored sectors of the economy. It confirms that businesses were on average able to transfer rising costs into sales.

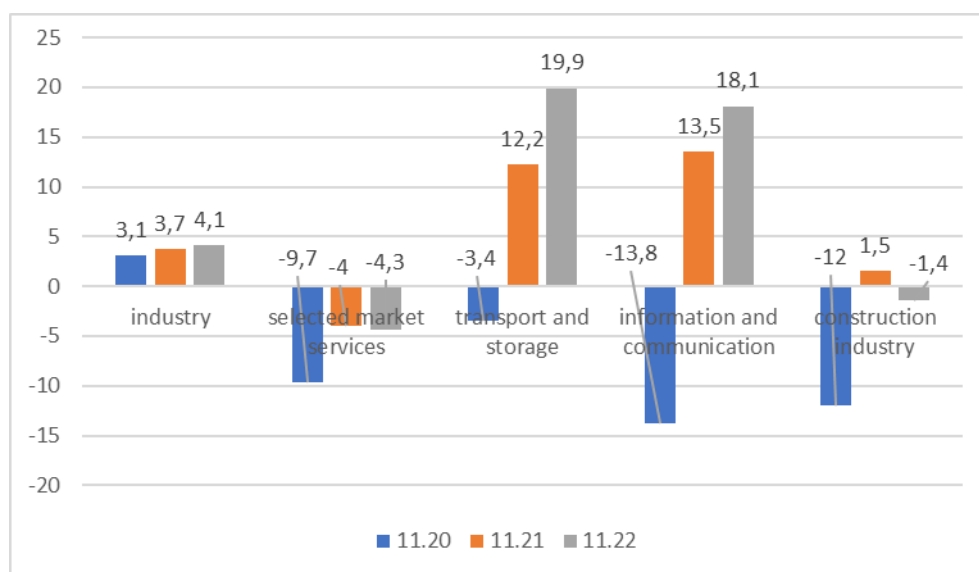


Figure 7. Change in sales of selected branches of the SR economy (year-on-year in %)
Source: Own elaboration according to the Statistical Office of the SR

However, the ability of companies to convert rising input prices into final output prices is diverse and depends on many factors, e.g. from the impact of the expected cooling of the economy on the demand for a specific type of product, from a specific industry, market position, financial health of the company, intensity of competition, etc. To a greater extent, long-term or luxury goods, or goods with energy-intensive production, will be affected. On the contrary, essential goods should experience a smaller decrease in demand. Many businesses are therefore exposed to the need to look for additional reserves in the area of operational efficiency.

4 Discussion

Positive benefits of business for society are primarily based on the creation of optimal conditions for its realization, as well as on the implementation of measures from regularly implemented measurements and analyzes of the needs and satisfaction of business entities. It is very important to monitor the quality of the business environment more intensively in times of uncertainty and changes brought to the market by the coronavirus pandemic. Creating suitable conditions for business is necessary at the current time, because the willingness to do business can be reduced in times of uncertainty. It is the task of the state, based on research, to systematically understand the pulse of the business environment, to create mechanisms for its continuous improvement, as well as to actively and effectively communicate them. Given the current situation on the market, it is also desirable to identify barriers that prevent or complicate the establishment of a business, or its development, promptly remove them and continue to simplify the entire mechanism of implementing business activities.

According to our findings, we recommend monitoring the prices of raw materials and inputs on world markets which are important for the company. Their development will, with a delay, also be transferred to prices in the Slovak Republic. Business management should be sufficiently self-sufficient to be able to reflect assumptions about the future development of macroeconomic disturbances in its decisions. Subsequently, it is necessary to assess them in a broader context, i.e. to assume adjustments to the legal and tax system by the state, etc.

In future research, it would be advisable to develop a quantitative econometric model that could be used to quantify the consequences of increased inflation on economic results of companies.

5 Conclusions

As shown, the development of the overall economic environment has an indisputable influence on the development of economic situation of businesses.

In 2020, the COVID-19 pandemic broke out, as a result of which SMEs had to cope with anti-pandemic measures.

The business sector was also affected by the consequences of the ongoing pandemic in 2021, but unlike in 2020, SMEs were already better able to deal with its negative impacts. The unfavorable economic situation caused by the pandemic had a negative impact on the creation of added value in the business sector in 2020. In 2021, there was a revival of economic activity, which was also reflected in the creation of added value, as well as other monitored economic indicators.

By comparing changes in prices in the production sphere with changes in sales of selected branches of the national economy of the Slovak Republic, we found out that SMEs managed to cope with the effects of increased inflation.

Even in times of economic growth, it is common for some companies to do better and some worse. Now, however, these differences will significantly deepen, and the deterioration of the situation of some companies may be serious. Many companies may be forced to take drastic action, even at the cost of an adverse impact on their own development. Acquisition activity may also increase, the competitiveness of some industries may deteriorate, and pressure on the labor market, which has so far resisted deterioration, may increase.

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