



**The usage of economic profit and other forms of profit as a part of prediction models to forecast the financial stability of business entities in the context of globalization**

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# Introduction

- In today's world of uncertainty and continuous change, it is in the interest of every business to increase its performance
- The term "prediction of a company's financial health" is well known in our global world
- Based on financial analyzes and financial health predictions, it is possible to take corrective measures well in advance, thus mitigating or eliminating any bankruptcy risk
- Financial analysis represents a basic aspect of financial management of a business entity and points to the operation of the company
- The state of financial stability of each entity is most reflected in the different forms of the profit indicator
- Predictive models, also called early warning systems, are used to identify the level of a company's financial health



# Methods

- Business failure is common to every economy in the world
- Accounting profit is considered to be a positive result of the company recorded as a mandatory information in the profit and loss statement, balance sheet and notes to the financial statements of the entity

EAT (earnings after taxes)	Income tax		
EBT (earnings before taxes)		Interest expense	
EBIT (earnings before interest and taxes)			depreciation
EBITDA (earnings before interest, taxes and depreciation)			

# Methods

- The concept of economic profit uses the cost of capital in calculations
- Economic profit is achieved if the company makes an accounting profit and at the same time can cover the cost of equity
- Alternative costs mean the best feasible opportunity, but it has not been realized

Economic profit = accounting profit - implicit costs

Economic profit = total return on capital - cost of capital

Economic profit = revenues - explicit costs - implicit costs

- The best-known indicators in foreign practice, which use the concept of economic profit to evaluate the company's performance, are:
  - EVA
  - INEVA
  - MVA
  - RONA



# Methods

- Financial prediction models are used to diagnose and predict a company's financial situation, but they can also be used to evaluate the results of its economic activities within a group of competing companies, or even within the industry
- Mathematical constructions of prediction models consist in a combination of various financial and economic indicators indicating financial stability at individual levels of financial management of business entities
- Due to the fact that profit is one of the basic indicators of this nature, we decided to examine the extent to which it is used on a sample of prediction models

# Results

First of all, we looked at it, if at all, and if so, how many prediction models use profit in their estimates



# Results

We also distinguished to what extent the types of profit are used, i.e. whether traditional forms of economic profit or accounting forms of profit are used more



# Results

- It can be seen in the first graph that 96% of the prediction models of the selected sample use a certain form of profit in their mathematical constructions of financial and economic indicators
- The second graph shows that, within the selected sample of models, forms of economic profit such as EVA, MVA, RONA or INEVA indicators are not part of mathematical combinations of financial and economic indicators for predicting the financial health of business entities
- However, forms of accounting profit are fully used, whether in the form of indicators such as EAT, EBT, EBIT, EBITDA or even cash flow



# Conclusions

- Bankruptcy is a situation where a company is unable to pay its debts and ultimately fails to meet its obligations
- Models of financial health assessment are made up of indicators, the combination of which indicates the very state of the entity at various levels of financial management
- In the presented article, we investigated the participation of profit and its various forms in the combination of these indicators in a selected sample of prediction models
- We conclude from the findings that the models do not use economic profit at all, but accounting profit is a very important part of assessing the stability and health of businesses through predictive models



**Thank you for your attention**

