

Assessing the Profitability of IT Companies: International Financial Reporting Standards

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Abstract: The article develops a business process for assessing and managing the profitability of companies operating in the field of information technology and establishes that in order to qualitatively analyse the state of profitability and opportunities to improve the company's financial performance, it is necessary to carry out a comprehensive analysis of financial activities as well as to determine how the company can increase absolute and relative profitability indicators. The study was aimed at achieving the goal of generalising theoretical and methodological provisions and developing practical recommendations on the process of assessing the profitability of companies operating in the field of information technology. In the process of building a business process for assessing and managing the company's profitability, attention is focused on the fact that the results of the profitability analysis should be used to further substantiate the strategic directions of the company's financial development. The obtained results allowed asserting that for effective management of the company's profitability, it is necessary not only to analyse the income statement but also to take into account the indicators of cash flows from various activities, which will allow planning more qualitatively and reasonably measures to improve the company's financial results and optimise its financial development strategy.

Keywords: Profitability, company development, financial result, cash flow, information technology, financial development strategy.

JEL Classification: D83, G14, G32.

INTRODUCTION

Ensuring the effectiveness of the financial management of a particular company in the field of information technology involves the substantiation, formation, and implementation of an adequate model for assessing and managing profitability as an integral system of forecasting, planning, and control over the processes of formation and distribution of financial results of the enterprise in the course of its financial and economic activities. This is one of the priority tasks of any company in all areas of its operating, financial, and investment activities since profitability is a comprehensive indicator of efficiency and effectiveness, which reflects all aspects and features of the company's business activities - the level of technology development, financial management, company strategy, etc. In this regard, the importance of timely assessment of the company's profitability and determining the prospects for growth of financial performance indicators is increasingly growing.

For companies operating in the information technology sector, the focus should be on the process of determining the

financial result itself, as due to the significant share of intangible assets in the company's total assets and the long production and financial cycle, the determination of financial results can be complicated. The preparation of financial statements by companies in accordance with international standards can facilitate the process of assessing their financial performance and creates greater transparency of business for investors, as international financial reporting standards (IFRS) are unified and allow for the analysis of the financial performance of companies registered in different countries.

IFRS make it possible to evaluate the profitability of companies operating in the information technology sector by various financial performance indicators and to define different groups of profitability indicators that give financial managers room for action and allow them making more informed management decisions.

Given the substantiated relevance of the research topic, it is logical to determine that the purpose of the work is to generalise theoretical and methodological provisions and develop practical recommendations on the process of assessing the profitability of companies operating in the field of information technology. In order to achieve this goal, the paper solves the following tasks:

To determine the areas of assessment of financial results of a company operating in the field of information technology;

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To assess what shortcomings, exist in the current approaches of most companies to assessing financial results and profitability;

To develop recommendations for the system of assessing improvement of the company's profitability operating in the field of information technology.

To achieve the objectives, the study used business process modelling tools, as well as general scientific methods, including analysis and synthesis, induction and deduction, generalisation, and specification.

1. LITERATURE REVIEW

A review of the literature on the analysis of international financial reporting standards in the context of financial performance and profitability indicators analysis shows that the authors mostly focus on two basic indicators: EBIT and EBITDA (Akgün and MemişKarataş, 2021;Gołaś, 2020). The calculation of EBIT and EBITDA is based on US GAAP reporting data, but EBIT and EBITDA are also used to analyse the financial condition and value of companies that report according to international standards. EBITDA was used to determine the company's ability to service its debt, i.e., this indicator, together with net profit, served as a source of information on how much interest payments the company could provide in the short term. First of all, EBITDA was used by investors who viewed the company not as a long-term investment, but as a set of assets that could be sold profitably separately, while EBITDA characterised the amount that could be used to repay loans (Isik, AydınUnal, andUnal, 2017;Lee, Har, andLee, 2018;Nguyenetal., 2020).

EBIT is an intermediate measure of earnings before interest and taxes.

EBITDA is a "cleaned" measure of net income before depreciation, interest, and income taxes, which allows you to evaluate a company's profit regardless of its impact:

- the amount of investments (amendment in the amount of accrued depreciation);
- debt burden (adjusted for interest);
- taxation regime (correction of income tax).

The main purpose of EBITDA is to allow for comparisons between different companies operating in the same industry, including for benchmarking purposes. It does not matter the size of investments, debt burden, or applicable tax regime - only the type of activity and operating results matter. Thus, EBITDA allows comparing companies with different accounting policies (for example, depreciation or asset revaluation), different taxation conditions, or debt levels. The only difference between EBIT and EBITDA is the inclusion or absence of depreciation in the formula. It expresses the depreciation of assets in the process of their operation (Reschiwati, Syahdina, andHandayani, 2022; Reschiwati, 2020;Yilmaz and Acar 2019).

If a company has numerous means of production on its balance sheet, it has to bear significant costs in the form of depreciation. This is not very relevant for information technology companies, so there is no critical difference between these two indicators for such companies. The aforemen-

tioned indicators allow you to calculate income without accounting for it. Economists most often use EBITDA to further assess the value of a company.

If going deeper into the analysis of the company's profitability, the literature (Shahniaetal., 2020;Youssef, Salloum, andAlSayah, 2022;Mansikkamäki, 2023) notes that these are relative indicators that allow assessing the economic efficiency of the company's activities. Profitability or productivity is a relative indicator that reflects the efficiency of using different types of company resources. Profitability, on the one hand, is an important indicator for investors and creditors, as it allows assessing the level of investment attractiveness and solvency of the company, and on the other hand, for the owners of the organisation, as it allows finding out how productive the company's management is.

Profitability can be calculated on the basis of the company's financial statements, namely the income statement and the statement of financial position (Canarella and Miller, 2018; Cooperand Lambertides, 2018).

Moreover, it can be analysed both on the basis of IFRS financial statements and on the basis of financial statements prepared in accordance with local standards. There are no recommended or standard values for profitability indicators. It all depends on the industry and type of activity of the organisation.

There are two types of profitability indicators:

- Indicators based on balance sheet data (Achim et al., 2022; Endri et al., 2020;Simon et al. 2021);
- Indicators based on financial results and production volumes (Dao and Ta, 2020; (Huang et al., 2022;Ni Luh Putu and I GedeMertha, 2018).

Table 1 shows a list of profitability indicators that are most commonly found in the literature and are calculated based on financial statements prepared in accordance with international standards.

Table 1. Profitability indicators most often found in the literature and calculated based on financial statements prepared in accordance with international standards for information technology companies.

Indicators	Calculation procedure
Profitability by balance sheet indicators	
Return on assets (ROA)	Net income / Average assets
Return on equity (ROE)	Net income / Average equity
Return on capital employed (ROCE)	EBIT / (Average assets - Average current liabilities)
Return on invested capital (ROIC)	Operating profit after tax / Invested capital
Profitability in terms of financial results and production	
Gross profitability	Gross profit / Revenue
Operating profitability	Operating profit / Revenue
EBIT margin	EBIT / Revenue

EBITDA margin	EBITDA / Revenue
Profitability before tax	Profit before tax / Revenue
Net profitability	Net profit / Revenue

Compiled by the author based on: Nufazil, 2018; Demiraj, Dsouza, and Abiad, 2022; Valaskova, Kliestik, and Gajdosikova, 2021; Pawełszek, Kumar, and Solanki, 2022).

Profitability indicators are considered in the dynamics and are also used to compare companies within the same industry. Unlike market multiples, they do not depend on the capitalisation ratio, which means that they allow us to abstract from the facts of undervaluation or overvaluation of the company's shares, from stock market trends, and its impact on the company's financial performance. For the stable development of IT companies, profitability indicators must grow. At the same time, it should be realised that the most attractive companies for investors are those with consistently high profitability indicators, not those that develop in a leapfrog fashion. Accordingly, managers of IT companies should make management decisions aimed at maintaining a gradual but stable increase in profitability.

2. MATERIALS AND METHODOLOGY

2.1. Methodology for Assessing the Profitability of Companies in the Field of Information Technology

The methodology for assessing the profitability of companies in the field of information technology is based on determining the basic indicators of financial analysis (Al-Zoubi, O'Sullivan, and Alwathnani, 2018; Harahap, Septiani, and Endri, 2020) based on financial statements prepared in accordance with international standards, respectively, for such calculations, methods of financial analysis are used, as well as time series analysis in order to determine trends in the development of the financial component of IT companies. The analysis of financial statements in accordance with IFRS also involves the use of a graphical method for visual presentation and interpretation of the obtained data.

2.2. Methodology for building business processes for assessing the profitability of companies in the field of information technology

Modern IT companies operate in an uncertain market, and therefore, one of the primary tasks of management is to identify, formulate and analyse the company's current and future profit generation and capabilities utilisation. Such a process requires processing significant amounts of information, which can only be achieved with the use of modern digital tools, including business model building.

The use of business modelling to form a system for assessing the company's profitability will allow consistently determining the list of stages that need to be implemented to obtain the most complete and comprehensive information not only about the current state of the company's profitability but also about the prospects for further growth of business profitability.

In this context, one of the most common modelling methods today is the use of the structural-functional method, which

aims to identify the elements necessary to perform the functions of a particular system and to identify the relationships between them. The structural-functional analysis focuses on identifying the general flow of information, its typification, and selecting the most significant, important, and significant aspects of the phenomenon from a large array of qualitative and quantitative aspects. This method according to the IDEF.0 standard is described in detail in Aleksieienko, Leliuk, and Poltinina (2020). The peculiarities of the IDEF0 standard are that it allows presenting the improvement algorithm in the form of a diagram, to visually present the sequence of actions for the formation of the main directions. A structural-functional model is an approach to describing and explaining systems that examines their elements and dependencies between them as part of a single whole, with individual social phenomena performing a specific function in maintaining and changing the social system. The SADT methodology used in this case is a set of methods, rules, and procedures designed to build a functional model of an object in a subject area. The SADT functional model reflects the functional structure of the object, i.e., the actions it performs and the relationships between these actions.

The use of structural and functional modelling to determine the sequence of actions in the process of assessing and managing the profitability of an enterprise will allow you to get a high-quality result with minimal time spent by managers on secondary processes and unimportant stages.

3. RESULTS

As a result of the study and analysis of scientific literature, it became possible to build an existing model for assessing and managing profitability in IT companies. In the future, it is advisable to identify the shortcomings of such a model and propose ways to optimise it.

In order to build a technology for managing the profitability of a company in the IT sector by means of structural and functional modelling, the SADT structural analysis technology (IDEF0 model) is used.

The essence of the structural approach to modelling business processes is its decomposition (breakdown) into automated functions: the system is divided into functional subsystems, which in turn are divided into sub functions, which are subdivided into tasks, and so on. The breakdown process continues down to specific procedures. The automated system retains a holistic view where all components are interconnected (Aleksieienko, 2020; Altaf and Shah 2018).

The building technology for assessing and managing a company's profitability begins with the construction of a contextual diagram (Fig. 1).

As the Fig. (1) shows, the contextual diagram of the process of profitability assessment and management includes the following elements of functional blocks:

A block of input information represented by the company's financial statements prepared in accordance with IFRS. These financial statements serve as the analytical basis for calculations to assess the financial performance of the company. They contain information on the absolute values of

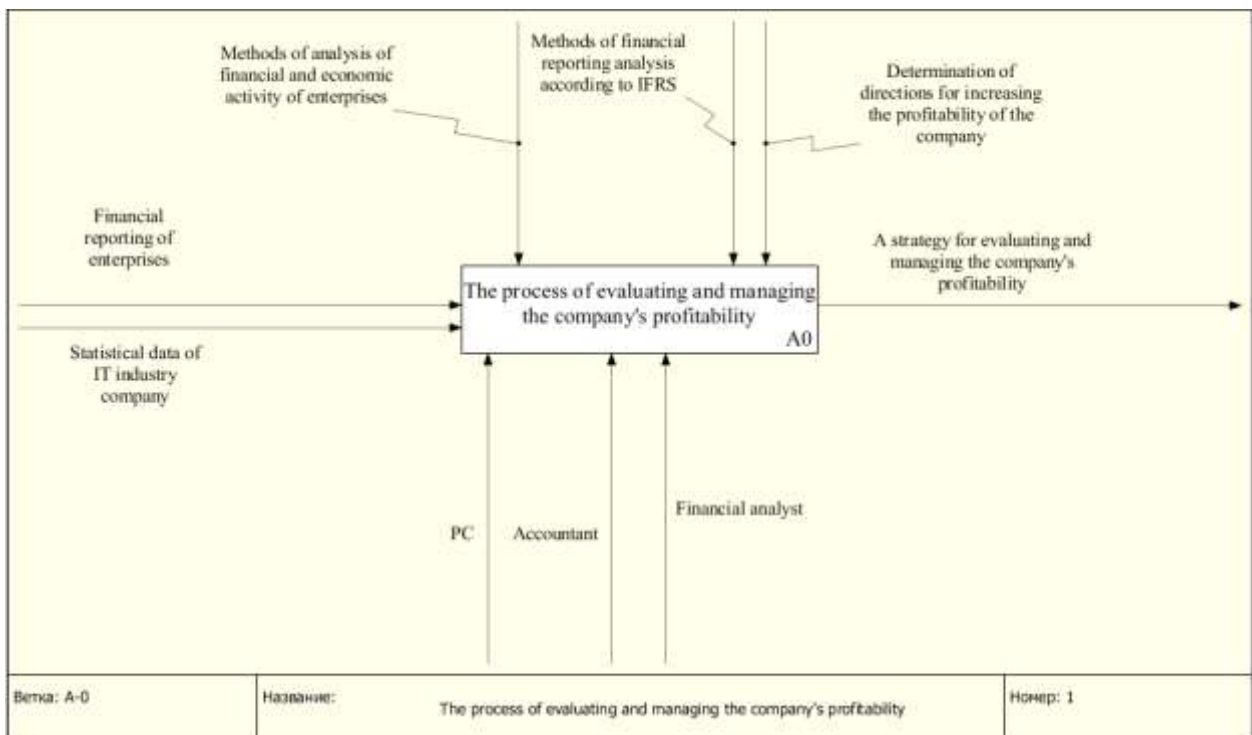


Fig. (1). Context diagram of the process “Assessment and management of company profitability” in the IDEF0 standard AS-IS model.

indicators characterising the formation and use of financial resources of the company and financial performance.

The management block includes methodological recommendations and regulatory support. In terms of the regulatory framework, approaches to calculating profitability indicators (Wassie, 2021; Kliestiketal., 2022) and International Financial Reporting Standards should be used to manage financial results. These documents provide the procedure for the formation and analysis of financial results to ensure the efficiency of their functioning.

The mechanism for assessing and managing the company's profitability includes a financial analyst and a financial director. A financial analyst is one of the company's senior executives responsible for managing the financial flows of the business, financial planning, and reporting. He or she determines the financial policy of the organisation, develops and implements measures to ensure its financial stability, analyses the financial performance of the company, and gives recommendations on planning and improving its economic efficiency. The main activity of a financial analyst is related to the analysis of financial performance indicators of enterprises, comparison of performance with competitors, and development of recommendations for improving performance indicators. The CFO is one of the company's representatives responsible for the financial areas of the company. The main goal of the CFO is to develop and approve a strategy for managing the company's financial results.

The purpose of the process of assessing and managing the company's profitability is to formulate and implement an effective profitability management strategy and develop optimal directions for implementing this strategy.

The next step is to decompose the contextual diagram, which provides a list of stages of assessing and managing the company's profitability in the field of IT services, as shown in Fig. (2).

According to Fig. (2), the technology of assessing and managing the company's profitability involves the direct calculation of profitability indicators and their interpretation. Each stage of the technology is implemented by using the previous stage data. This sequence of stages reflects the logic of actions of a financial analyst in the process of managing the company's profitability. The first stage involves the financial statements analysis based on the information base. The essence of this stage is that as a result of processing the financial statements data, the main elements of the financial statements that have the greatest impact on the company's profitability are identified. On the basis of the formed information base, a coefficient analysis of the financial condition of the company is carried out. The analysis of the financial condition of the company is carried out by determining and assessing the property status of the company, as well as the sources of its capital formation. The regulatory framework for analysing these indicators is the guidelines for determining financial indicators. At each of these stages, relative indicators are determined and compared with the normative values to determine the overall financial condition of the company and provide recommendations for its improvement. It is worth emphasising that it is not logical to assess the company's profitability separately from the overall financial analysis since only a comprehensive view of the company's financial condition and the reasons for its changes can give a positive result.

Further, on the basis of the formed basis of analysis, it is necessary to analyse the dynamics and structure of the finan-

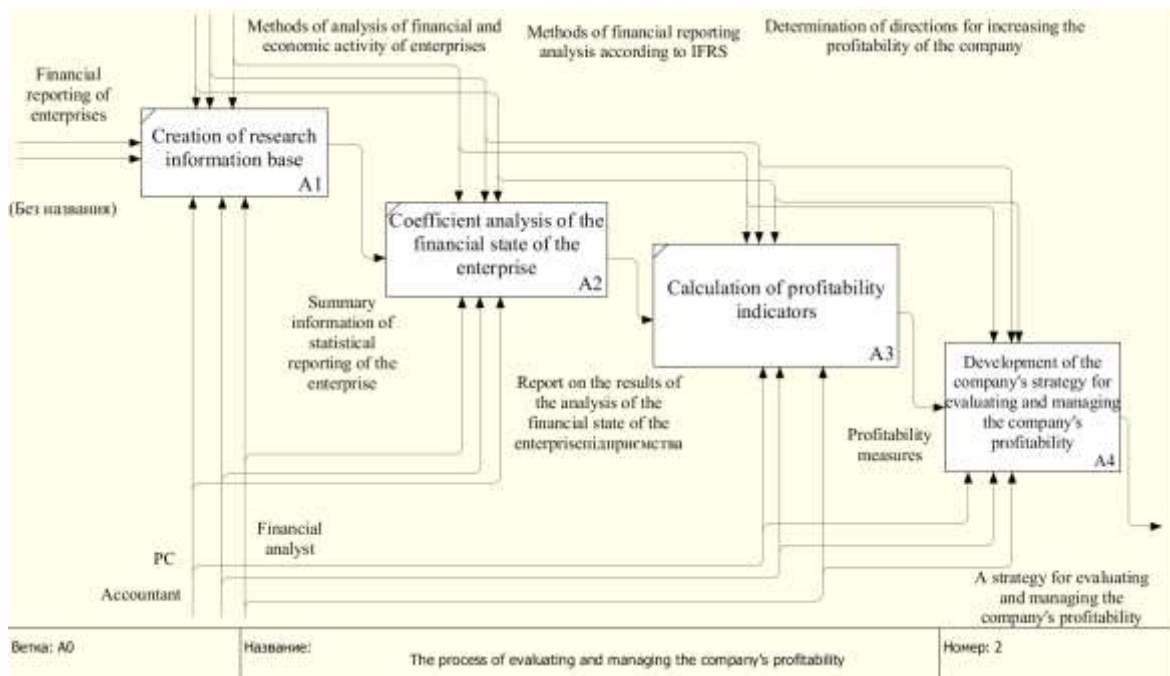


Fig. (2). Decomposition of the context diagram of the process “Assessment and management of company profitability”

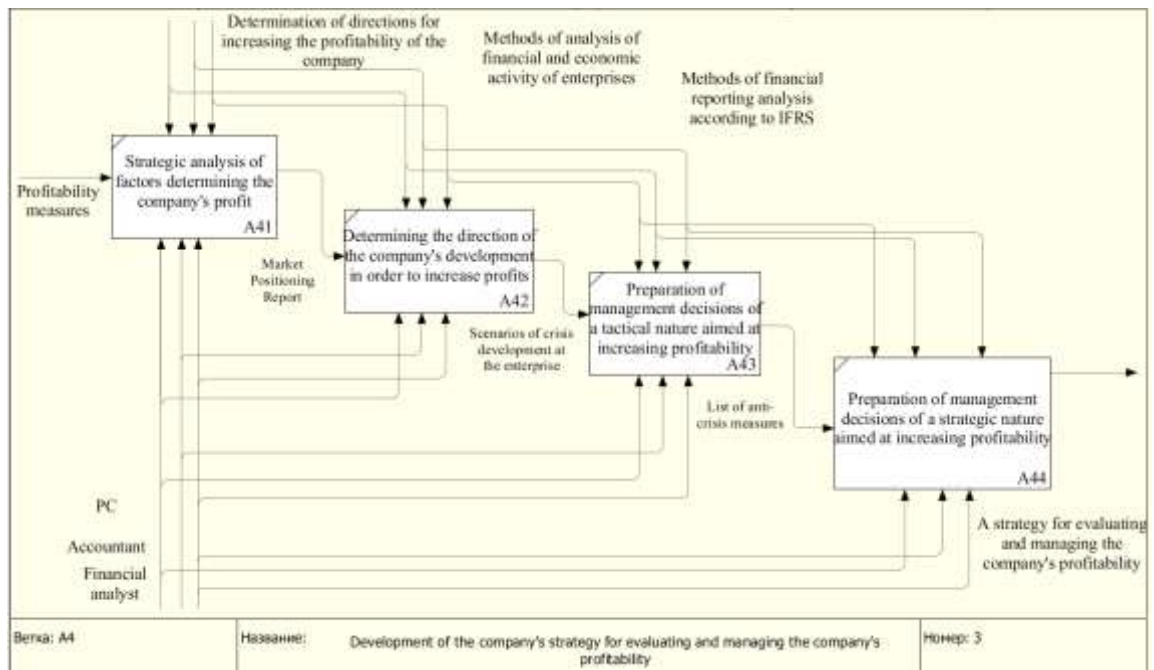


Fig. (3). Decomposition of the stage “Development of a strategy for assessing and managing the company's profitability”.

cial results of the enterprise with the subsequent determination of relative profitability indicators. The stage of assessing the dynamics and structure of financial results should be carried out as follows. First, it is advisable to analyse the dynamics of absolute financial performance indicators for three years, namely: the net income, the gross profit, the financial result from operating activities, and the net profit of the company. If, in accordance with IFRS, the company separately determines the income from the provision of services and the sale of products, then both areas of activity should be analysed. The regulatory framework for evaluating these indicators is the guidelines for analysing financial results

(Ardalan, 2017; Kayani, DeSilva, and Gan, 2020; Nguyen et al., 2023; Prokopenko, 2022). Analysing the dynamics of these indicators will allow drawing a general conclusion about the trends observed at the enterprise and indicate the main existing problems that may exist at the enterprise.

The next stage of assessing and managing the company's profitability is to identify the factors and reasons that influence the formation of the company's profitability management strategy. Thus, the decomposition diagram of the stage “Development of a strategy for evaluating and managing the company's profitability” is shown in Fig. (3).

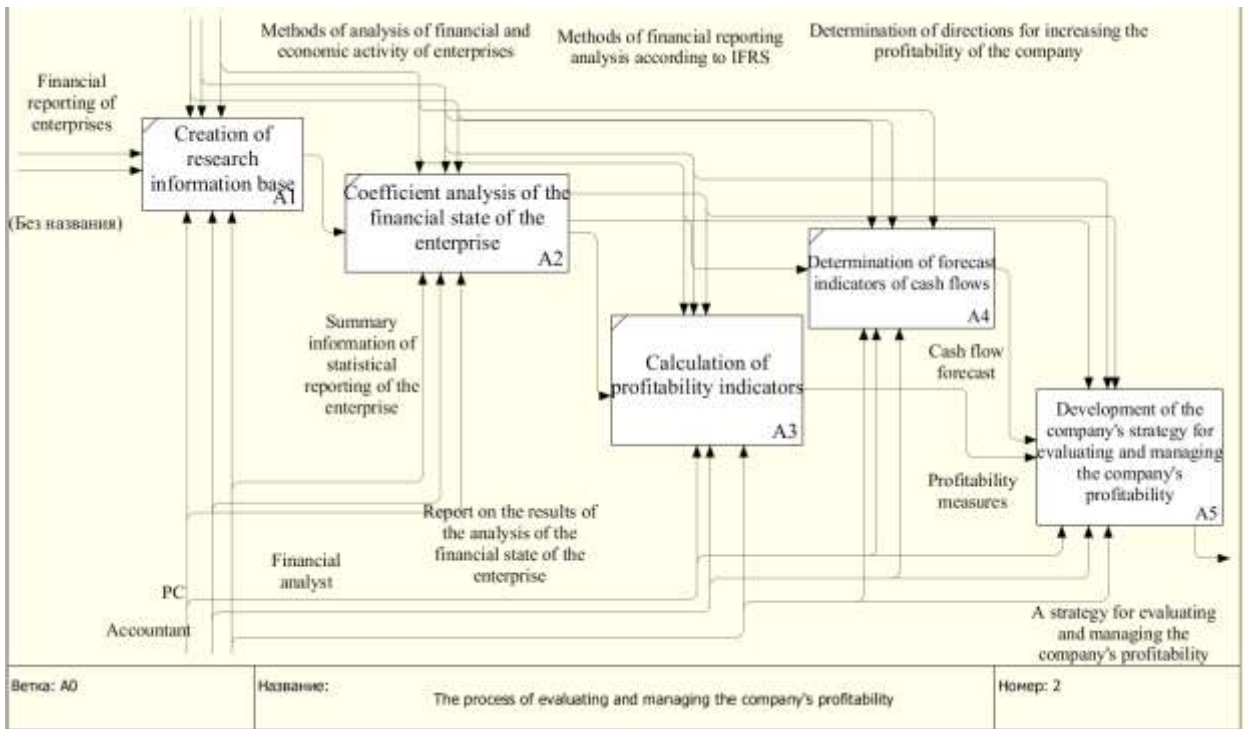


Fig. (4). Decomposition of the improved model for assessing and managing the profitability of companies in the field of information technology.

The main stage in Fig. (3), the development of a strategy for assessing and managing the company's profitability, involves a process of strategic and operational changes aimed at reorienting the current strategy to match its internal capabilities with the conditions of the external environment. Each process of operational planning involves the performance by economic managers of such stages of activity as choosing a strategy for the company's development and promotion of its goods or services, justifying the form of settlements with customers, determining the optimal conditions for the provision of services and remuneration (hourly or for a completed project), developing the basic calendar and planning standards, operational planning of production units, organizational preparation of production, direct organisation of operational work, current control and regulation of financial Strategic profitability management is based on the principles of strategic planning, strategic organisation, and strategic control, i.e., a general set of actions aimed at improving the efficiency of the company's profitability management. This stage also involves the development of long-term goals and targets for the development of the company's profitability.

Based on the specifics of the activities of companies in the field of information technology, the main activities of a financial analyst are related to the analysis of financial performance indicators of enterprises, the comparison of performance with competitors, and the development of recommendations for improving performance indicators, while taking into account the specifics of software development or high-tech product development, since such companies often require significant investments at the start of the project, and the cash flow from the project implementation can be

The CFO's main function is to make financial management decisions and approve the main plans and recommendations for the company's further operation, with a focus on increasing profitability.

Figs. (1 – 3) show the technology for assessing and managing the profitability of an information technology company used by most modern companies in the above-mentioned sphere, but the study found that it is irrational to assess the company's performance solely on the basis of profit indicators, and it is worth focusing on cash flow indicators as well. The author's proposed approach to assessing and managing the profitability of a company in the field of information technology is shown in Fig. (4).

In Fig. (4), a block for forecasting cash flow indicators has been added; here it is advisable to focus the financial analyst's efforts on forecasting net cash flow from various activities. Profitability indicators are certainly important for a company, but only a parallel analysis of forecasted cash flows will allow assessing the real state of solvency and efficiency of each company.

Companies operating in the information technology sector may have significant amounts of receivables and payables, and therefore cash flow indicators can be much more informative for analysing the financial position and justifying financial decision-making in the context of increasing profitability.

In accordance with IFRS, modern information technology companies can analyse cash flows from operating, investing, and financing activities. Each of the three activities requires attention and should be analysed in the context of the possi-

Table 2. Comparison of Models of the Existing and Proposed author's Approach to the Implementation of Procedures for Assessing and Managing the Company's Profitability in the Field of Information Technology

The Direction of Analysis and Evaluation	Existing Approach	Author's Approach	Differences
Analysing the external environment	To be held	To be held	-
Conducting a general financial analysis of the company	To be held	To be held	-
Assessment of absolute and relative indicators of company profitability	To be conducted solely on the basis of financial performance indicators	To be carried out taking into account cash flow indicators	Analysis of cash flows in tactical and strategic terms makes it possible to identify more risks and bottlenecks in the company's operations
Analysis of cash flows from various types of activities	Not carried out	It is carried out and taken into account for further formation of the company's development strategy	Takes into account the company's development prospects and financing opportunities
Developing a strategy for assessing and maximising the company's profit	Conducted and based on general financial analysis by profitability indicators	It is conducted and takes into account not only the results of financial analysis and profitability assessment but also the forecast of cash flows from various activities	Strategy development is based not only on the current situation in the company but also takes into account the cash flow forecast

bility of generating incoming cash flow, along with profit and profitability indicators.

After determining the dynamics of profitability and cash flow indicators, it is possible to conduct a further analysis in order to determine the factors that influenced the change in the main result indicators, which can be done on the basis of factor modelling or regression-correlation analysis.

Summarising the above, it should be concluded that the proposed model for optimising the process of assessing and managing the company's profitability in the field of information technology will allow the company to use its available resources more efficiently, plan its activities in advance and effectively manage profits, which in turn will allow the company to maximise the performance of its employees.

The next step is to compare the existing and the proposed author's approach to the implementation of procedures for assessing and managing the company's profitability in the field of information technology - Table 2.

Thus, according to the information presented in Table 2, it is obvious that the analysis and in-depth evaluation of cash flow indicators in the context of profitability assessment is an extremely important stage in the development of a company's strategy and the formation of prerequisites for making sound and balanced management decisions.

In general, it is worth noting that it was proposed to improve the process of assessing and managing the company's profitability by performing three stages:

The identification of factors and reasons that affect the formation of profit and profitability indicators of the company;

Forecasting the company's cash flows from various activities;

The development and implementation of a strategy for managing the company's profitability, taking into account the

specifics of its activities and operation in the field of information technology.

In general, following all the stages depicted in the business process models will help to maximise the effect and make informed and balanced financial management decisions.

CONCLUSIONS

As a result of assessing the profitability of companies directions analysis in the field of information technology based on the use of financial statements prepared in accordance with IFRS, the author has implemented structural and logical modeling of this process and also supplemented the approaches used by companies today with a recommendation to conduct an in-depth analysis and forecasting of cash flow indicators for a more informed formation of the company's financial development strategy.

Overall, the study allows drawing the following conclusions:

1. It has been determined that the process of evaluating and managing profitability is one of the key ones and requires careful planning in information technology companies since in this area namely companies may have problems with planning cash flows and finding financing for certain projects. In accordance with the theoretical aspects of financial results, a modern business process model for assessing and managing profitability has been developed. The technology of profitability management involves the implementation of the following stages: analysis of the external environment and market conditions; analysis of the general financial condition of the enterprise; assessment of the dynamics and structure of absolute and relative indicators of the company's profitability; identification of factors and reasons that affect profitability; formation of a general strategy for managing the company's profitability.

2. It is determined that the implementation of the existing technology of profitability management does not sufficiently

ensure an increase in the level of efficiency of formation and use of financial results at the enterprise, therefore it should be improved and enhanced by introducing an additional stage of analysis of cash flow indicators.

3. It is proposed to improve the process of managing the company's profitability and expand it into three components: determining the factors and causes that affect financial results; forecasting the results of cash flows for each type of activity; developing and implementing a strategy for managing the financial results of the enterprise.

The implementation of each of the stages will minimise unforeseen events related to the formation and use of financial results and will ensure a long-term increase in the profitability of companies operating in the field of information technology.

CONFLICT OF INTEREST STATEMENT

The author declare that they have no conflict of interest.

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