

PERFORMANCE ASPECTS OF COMPANIES WORKING UNDER THE CMT SYSTEM

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Abstract: The current study describes the notions regarding production under the CMT system (cut, made, trim), the CMT contracts and the particularities of this type of production. The case study presented in the paper puts forward the definitions of performance and its indicators, such as effect over resources, economic and financial profitability.

Among the forms of economic collaboration, CMT (cut, made, trim) is one of the most common in Romania. A feature of the CMT system is represented by the scope of the operation, which is to process materials, raw materials and semi-finished goods belonging to one party (the importer or the exporter). Since the object of CMT is mainly the use of the labour force, CMT is also called “sale of labour”.

CMT is defined as “a form of international economic collaboration which consists of transactions carried out on the basis of a contract between two companies from different countries, one executing a product on order in accordance to the models, designs and materials of the second company, under the brand of the latter. The company that places the order is called credit accountant, and the company that manufactures the product is called executor. The credit accountant fulfils the function of exporter, and the executor fulfils the function of importer.”¹

The CMT contract is defined² as “a written agreement between a producer and a beneficiary, the latter committing to put at the disposal of the producer various raw materials and materials with the purpose to adequately process them in accordance with the technical documentation and requirements of the beneficiary, in exchange for a monetary or in kind remuneration. It is a contractual agreement widely spread throughout various industry sectors within international cooperation relationships, especially in the clothing, footwear and furniture industries”.

The definition above shows that the CMT contract involves two partners, one executing an ordered product after the models, designs and materials of the other partner under the brand of the latter.

In terms of the manpower, CMT operations may be classified as follows:

- Active CMT (manpower export)
- Passive CMT (manpower import)

In the active CMT, the exporter processes the material supplied by the importer and exports it to their owner. In the passive CMT, the importer sends his materials for processing in the country of the exporter and brings them back as finished products.

After reviewing the documents of a company working under the CMT system, whose main activity is “manufacturing rubber soles, pelax soles, uppers and assembling the elements of the footwear through gluing or clinching”, we noticed it practices an active CMT and the active processing operations are carried out without transferring ownership over the merchandise, the goods are imported in order to be processed and are sent to their beneficiary. The production activity takes place on the basis of the CMT contracts.

The main activities of the CMT processing operations are:

- The importer doesn't have the materials and raw materials that correspond in terms of the requirements expressed by the exporter;
- The existent surplus of capacity;
- Exploiting the differences between levels of achievements in different countries (at our reviewed company the average earning was below 200 Euros per month).

By working under the CMT system, the exporter has the following advantages:

- no concern regarding the supply of raw materials and materials;
- improving the skills of the labour force;
- favouring the import of technology;
- expanding the market;
- ensuring employment;
- opening large perspectives for cooperation actions.

¹ Georgeta Busa- coordinator, Complete Dictionary of Market Economy (Dictionarul complet al economiei de piata), Informatia Business Books Publishing, 1994, Bucharest, p. 208

² Toma Georgescu, Gheorghe Caraiani, Foreign Trade Techniques (Tehnici de comerț exterior), Sylvi Publishing House, Bucharest, 1995

The advantages for the importer are:

- increased profit due to the differences of value among countries;
- increasing the business volume and the supply of goods without investments in production;
- strengthening the market position given the fact the products are sold under his brand.

The disadvantages of the CMT system are:

- for exporter:
 - loss of market, meaning closing transactions in unfavourable conditions;
 - delays in the supply with raw materials and materials;
 - price disadvantage;
 - the exporting company remains an unknown in terms of the brand;
- for importer:
 - the lack of rhythm with the deliveries of the partner;
 - the partner could record a high percentage of rejects until the model is assimilated.

The CMT contract signed with the company where the documentation was conducted is structured as follows: contracting parties, subject of the contract, duration, price, payment methods, obligations of the contracting parties, indemnities, other clauses, partial invalidation, division of the contract, waiver of rights, surrendering the contract, force majeure, criminal clause, confidentiality clause, resolution of dispute, terminating the contract, final provisions. It has to be mentioned that in our case study the external price for CMT is established in accordance with the direct and indirect expenses incurred by the production of finished goods, to which a profit share is added. The cost of the manpower is represented by the salaries of the employees and is determined by starting from the physical time required to manufacture the goods and from the average price per minute.

The direct manpower cost is obtained by multiplying these amounts. The expenses with the contributions for social security, social health insurance, unemployment fund, social solidarity fund, etc. are added to this cost, as is a share of the indirect expenses of the company (energy, water, fuels, maintenance and repairs, postal expenses, indirect wages, financial costs). The profit share applied by the company is usually 20%, but it may have other values also (5% - 15%).

We must mention as a particularity of accounting the use of the 8032 account “Assets held for processing or repair”, used for the accounting of the raw materials processed in the CMT system.

We'll determine the performance of this company next.

Table 1. The main positions in the balancesheet for the years N, N+1 are:

POSITION	ASSET - year		LIABILITIES - year	
	N	N+1	N	N+1
Total frozen assets	42.012	34.135	-	-
Circulating assets	19.400	232.832	-	-
Debts < 1 year	-	-	55772	98.063
Debts > 1 year	-	-	-	-
Equity capitals	-	-	5.640	168.904
Total	61.412	266.967	61.412	266.967
Indicators according to the balance sheet				
Net circulating assets (NCA)	36.372	134.269		
Total assets minus current debts	5.640	168.904		

Table 2. The synthesis of the profit and loss account for the years N and N+1:

Indicator	N	N+1	%
Net turnover	563.431	999.543	177.40
Operating revenues	563.431	999.543	177.40
Operating expenses, including:	551.777	805.318	145.95
- raw materials and materials	16.387	18.872	115.16
- other materials	15.155	33.709	208.66
- other external expenses	48.783	67.070	137.49
- personnel expenses	313.148	429.282	137.09
- adjustments	-	7.877	-
- other operating expenses	157.304	248.508	157.98

Indicator	N	N+1	%
Operating profit	11.654	194.225	1.666,6
Financial incomes	16	138	862,5
Financial expenses	-	-	-
Financial profit	16	138	862,5
Extraordinary incomes	-	-	-
Extraordinary expenses	-	-	-
Extraordinary profit	-	-	-
Total revenues	563.447	999.681	177,42
Total expenses	551.777	805.318	145,95
Total profit	11.670	194.363	1.665,49
Income tax	1.036	31.100	3.001,93
Net profit	10.634	163.263	1.535,29

From the projected data in the balance sheet, it results that in year N the company recorded a negative working capital of -36.372 lei, and in year N+1 the working capital was 134.269 lei.

The performance indicators of the profit and loss account had had positive trends so the net profit rose by 15,35 times in N+1 compared to N. This was due to a turnover higher by 1,774 times in N+1 compared to N. It should be also noted that out of the total operating expenses, the personnel expenses were 56,75% in year N and 53,31% in N+1, while raw materials expenses were 2,93% in year N and 2,34% in N+1.

Out of the total operating expenses, the external benefits were 28,5% in year N and 30,85% in year N+1.

The profit rates³ are determined as a ratio between results and means or result and activity. The results may be the gross profit or the net profit, and the means may be fixed assets of gross or net capitals, total assets, etc. The activity indicators are the turnover, the production cost, the added value, the depreciation, etc.

Based on the data in the balance sheet from years N and N+1 and from the profit and loss account from years N and N+1, we will determine the performance indicators.

The etymology of the word performance comes from the Latin word *performare*, which means “to give shape to something”⁴. In English the verb *to perform* means to do something with regularity, method and implementation, to execute, to lead to its accomplishment in a convenient manner.

The economic-financial performance is defined by Gheorghe O. Bistriceanu in his book, *Lexicon of Financing-Banking*, vol. III, Economica Publishing, Bucharest, 2001, p. 31, as being “a higher quality level of the economic and financial activity carried out by economic agents, which is assessed with the help of several indicators, such as: turnover, return on capital, work productivity, return on equity, gross and net profit, annual renewal rate of the fixed capital, the efficiency of use for fixed assets, etc.”.

In what follows we will present the concept of performance after the year 1990. For example, Amick Bourguignon (1995) defines performance in terms of management as being “the accomplishment of the organizational objectives”. A. Bulrland, M. Friederich, G. Langlois show that “performance is not bad or good in itself. The same performance may be appreciated as good in itself. The same performance may be regarded as good when the target is modest or it may be regarded as bad when the target is ambitious.”

M. Niculescu (2003) ties performance to the enterprise’s productivity and effectiveness: “an enterprise is theoretically efficient if it is productive and effective at the same time”. P. Lorino (1995) says that “for an enterprise the performance represents the thing that will contribute to the improvement of the value-cost relation, not only what contributes to the reduction of the cost or the increase of the value”.

We believe the enterprise’s performance is a complex concept, which may be measured through a series of indicators and which shows its position in the competitive environment.

³ Gheorghe I. Ana, *Profit (Profitul)*, Economica Publishing House, Bucharest, 1998, p.72-78

⁴ Iulia Jianu, *Evaluarea, prezentarea și analiza performanțelor întreprinderii*, Editura CECCAR, Bucharest, 2007, p. 12, 19, 21, 23, 24

No. crt	Indicator	Calculus formula	U.M.	N	N+1	$\frac{N+1}{N} * 100$
A. Return on capital						
a) Return on capital		$R_c = \frac{\text{Gross, net profit}}{\text{Used profit}} * 100$ (total assets, frozen assets, circulating assets)	%			
1		$R_{c1} = \frac{\text{Gross profit}}{\text{Total asset}} * 100$	%	$\frac{1160}{6142} * 100 = 19,00$	$\frac{1933}{2697} * 100 = 71,8$	383,16
2		$R_{c2} = \frac{\text{Gross profit}}{\text{Total frozen assets}} * 100$	%	$\frac{1160}{4202} * 100 = 27,8$	$\frac{1933}{3415} * 100 = 56,40$	2.049,68
3		$R_{c3} = \frac{\text{Gross profit}}{\text{Circulating assets}} * 100$	%	$\frac{1160}{1940} * 100 = 60,15$	$\frac{1933}{2282} * 100 = 84,7$	138,79
4		$R_{c4} = \frac{\text{Net profit}}{\text{Total assets}} * 100$	%	$\frac{1064}{6142} * 100 = 17,32$	$\frac{1623}{2697} * 100 = 61,15$	353,06
5		$R_{c5} = \frac{\text{Net profit}}{\text{Frozen assets}} * 100$	%	$\frac{1064}{4202} * 100 = 27,8$	$\frac{1623}{3415} * 100 = 48,2$	1.889,73
6		$R_{c6} = \frac{\text{Net profit}}{\text{Circulating assets}} * 100$	%	$\frac{1064}{1940} * 100 = 54,81$	$\frac{1623}{2282} * 100 = 71,11$	127,91
b) Return on social capital		$R_{rsc} = \frac{\text{Gross, net profit}}{\text{Social capital}} * 100$	%			
1		$R_{rsc1} = \frac{\text{Gross profit}}{\text{Social capital}} * 100$	%	$\frac{1160}{20} * 100 = 5835$	$\frac{1933}{20} * 100 = 9718,1$	1.665,49
2		$R_{rsc2} = \frac{\text{Net profit}}{\text{Social capital}} * 100$	%	$\frac{1160}{20} * 100 = 5835$	$\frac{1623}{20} * 100 = 8115,1$	1.535,29
c) Return on equity		$R_{re} = \frac{\text{Gross, net profit}}{\text{Equity capital}} * 100$	%			
1		$R_{re1} = \frac{\text{Gross profit}}{\text{Equity capital}} * 100$	%	$\frac{1160}{560} * 100 = 207,1$	$\frac{1933}{16904} * 100 = 11,50$	55,61
2		$R_{re2} = \frac{\text{Net profit}}{\text{Equity capital}} * 100$	%	$\frac{1064}{560} * 100 = 189,5$	$\frac{1623}{16904} * 100 = 9,66$	51,26
d) Return on used funds		$R_{ruf} = \frac{\text{Gross, net profit}}{\text{Cpcc}} * 100$ Pmcp=Comodity production at production cost	%			
1		$R_{ruf1} = \frac{\text{Gross profit}}{\text{Cpcc}} * 100$	%	$\frac{1160}{5400} * 100 = 21,4$	$\frac{1933}{9000} * 100 = 21,4$	918,06

2		$R_{ru/2} = \frac{\text{Net profit}}{\text{Cpcc}} * 100$	%	$\frac{1064}{5010} * 100 = 19,22$	$\frac{16263}{98100} * 100 = 16,66$	845,68
e) Rate of return in relation to the turnover						
1		$R_{rt1} = \frac{\text{Gross profit}}{\text{Turnover}} * 100$	%	$\frac{1160}{5641} * 100 = 20,56$	$\frac{19436}{99543} * 100 = 19,52$	939,61
2		$R_{rt2} = \frac{\text{Net profit}}{\text{Turnover}} * 100$	%	$\frac{1064}{5641} * 100 = 18,86$	$\frac{16263}{99543} * 100 = 16,33$	864,02
f) Return on permanent capital						
		$R_{rpc} = \frac{\text{Gross.net profit}}{\text{Permanent capital}} * 100$ are equal with equity capitals without being >1	%			
B. Economic profitability⁵						
1	Epg (gross)=	$\frac{\text{Gross operating surplus}}{\text{Invested capital}} * 100$	%	$\frac{1115}{1034} * 100 = 107,83$	$\frac{44168}{16263} * 100 = 272,33$	17,97
2	Epn (net)=	$\frac{\text{Operating surplus}}{\text{Net invested capital}} * 100$	%	$\frac{1164}{1064} * 100 = 109,40$	$\frac{19425}{15386} * 100 = 126,20$ 155,386=163,263-7,877	114,12
<p>Where $CI=AE+NFRG+D$ or $CI=Equity\ capitals+DTML+CT$ Where $AF=$ represents gross fixed assets, $NFRG=$working capital requirements, $D=$equity capital availabilities, $DTML=$medium and long term facilities, $CT=$ short-term bank debt $EBE=$gross value added + operating subsidies – Taxes, duties and assimilated payments – Personnel expense Value added= The production of the exercise + Incomes from sale of goods – Consumptions of goods and services provided by third parties for this production / Expenses with goods + Total material expenses + Expenses with works and services executed by third parties. In our case : $VA_N=563.431-(13.387+16.155)-48.783=563.431-84325=485.106$ $VA_{N+1}=999.543-(18.872+33.709)-67.070=879.892$ $EBE_N=482.106-7.843-313.148=161.115$ $EBE_{N+1}=879.892-429.282-6.002=444.608$ $RE_N=161.115-0-149.461=11.654$ $RE_N=EBE+Incomes\ from\ depreciation\ and\ provisions + Other\ incomes - Expenses\ with\ depreciation\ and\ provisions - Other\ expenses$ $RE_{N+1}=444.608-7.877-241.938-568=194.225$</p>						
C. Financial profitability						
	Rf=	$\frac{\text{Net profit}}{\text{Equity capital}} * 100$	%	$\frac{1064}{5640} * 100 = 188,55$	$\frac{16263}{168904} * 100 = 96,66$	51,26

The complexity of determining the performance of the company and the opportunity of its varied expression results from the data presented above.

References:

- 1) Burja, C. Financial Economic Analysis, Risoprint Publishing House, Cluj Napoca, 2005, p. 31

⁵ C. Burja, Financial Economic Analysis (Analiză economică financiară), Risoprint Publishing House, Cluj Napoca, 2005, p.31

- 2) Gheorghe I. Ana, Profit, Economică Publishing House, 1998, p.72-78
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- 6) Luha, V., Commercial Law, Altip Publishing House, Alba Iulia, 2003

