

NON-FINANCIAL BACKGROUND OF FINANCIAL PERFORMANCE: EVIDENCE FROM CENTRAL AND EASTERN EUROPE

Gyorgy Andor⁵⁶³
Tamas Toth⁵⁶⁴

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Abstract: *This research concerns the relationship between progress in financial performance and firm characteristics, such as the applied capital budgeting methods, the presence of a code of ethics, the firm size, the extent of management ownership, and the presence of Western management culture, in Central and Eastern European (CEE) firms. The data of 218 non-listed companies are used from a survey in 2006 that focused on the capital budgeting practices and other characteristics of firms. The most important financial variables—sales, earnings before interest and taxes (EBIT), total assets, equity, debt, return on equity (ROE), return on assets (ROA), debt to assets, equity to assets, and number of employees—are analyzed, reflecting the financial progress of these firms from 2005 to 2012.*

Companies that do not use a formal capital budgeting technique have a significantly worse average financial performance than do companies that use a formal capital budgeting technique; companies using discounted cash flow (DCF) methods have the best performance. No significant difference in financial progress is found between firms using only accounting-based (AB) methods or DCF methods. The presence of a code of ethics appears to be a strong separation parameter—companies with a code of ethics usually outperform companies without one. The size of a firm is also shown to have a significant impact on financial progress. Companies with a high management ownership show better ROE and ROA than companies with a low management ownership. Finally, this study identifies better financial performance for firms with a Western management culture.

Key words: *capital budgeting practice; code of ethics; size effect; management ownership; financial performance; Central and Eastern Europe*

⁵⁶³ Eotvos Lorand University, Institute of Business Economics; Neumann Janos University, Faculty of Economics and Business; Hungary

⁵⁶⁴ Eotvos Lorand University, Institute of Business Economics; Neumann Janos University, Faculty of Economics and Business; Hungary