

Cash Flow Management as an Indicator of a Latent Crisis in the Company

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Summary: The aim of the paper is to highlight the importance of management cash flow as an indicator of a latent crisis in the company. If there is an early identification of risk factors affecting cash flow and proposed measures to remove them, don't have to lead to financial crisis in the company. The most appropriate way of early identification of risks in company is controlling.

Key words: cash flow, crisis, company, controlling.

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1. Early Identification of Company Crisis

At present the financial and economic crisis in the world also in Slovakia has shown us that establishing of good control system in the enterprise become an essential part of survival. Business managers affect with their decisions the efficiency, quality, economic efficiency and overall success in any company. Sometimes managers ignore the real changes in the neighborhood and resulting threats to the enterprise. Therefore this could cause one of the biggest crises in business. This requires early and flexible approaching by managers on all levels, effort to learn the identification evaluate risk and act correctly in the latent phase in a business crisis. Root cause the identification of is mentioned as a correct identification risk factors and future estimation. Not at all hazards are the primary cause the existence company. It is important to notice, as the risk contributing as it self the overall risk position of the company.

Crisis in company is quite difficult phenomenon and there is no accurate procedure instruction. Solution to resolve the crisis, but exists as to prevent the crisis. It is important to have sufficient interest in developing measures to prevent the crisis in the company, which may lead to bankruptcy of the company. [7]

Identification of the crisis for company is really important. Between the company and their neighborhood is a constant balance and also subsystems within company are distorted. The distortion of balance occurs by the action of risk factors, the most effective of them are people, production facilities accident, natural disasters etc. A management expert states that 70-80 % of business activities has its origin in surrounding area by inappropriate responses management or owners. Majority of all crises (90 %) the enterprise causes itself and majority anticipate on their establishing as well.

Successful solution of the crisis depends on its early detection. In the interest of the company should be early identification of occurring crisis within the crisis chain as closed to its beginning. In the particularly situation when we can easily and quickly identify the true-root cause of the crisis and causes of crisis where the consequences are not for enterprise sense and crisis still did not appear in financial field. It is a latent phase of the crisis in the company when the imbalance starts to grow up and attack the other business areas.

At this stage it is already possible to identify some of the symptoms of crisis or indicators, risk

factors, which indicate a level (to quantify and compare) deviations from balance state in some business sphere. As these indicators do not show yet in the financial field, it does not pay attention to them.

The indicator has a kind of nature common and value indicator, or standard economic achievements under comparable conditions. Identification of these symptoms is possible on the basis of indicator trends especially of risk factors affecting cash flow and soft signals. If we miss the negative trends and discover solutions problems, then enlarging imbalance continues. Latent phase of the crisis in the company may take several months or even years before the imbalance will reach the critical capacity – based on that crisis will perform into acute phase of drive in Figure 1.

1. Cash flow management as an indicator of a latent crisis

Do not let the company into insolvency, inability to pay the contract have to manage cash flows (cash flow) as well as from company to company and have to know the level and structure of their costs. Managing cash flow has

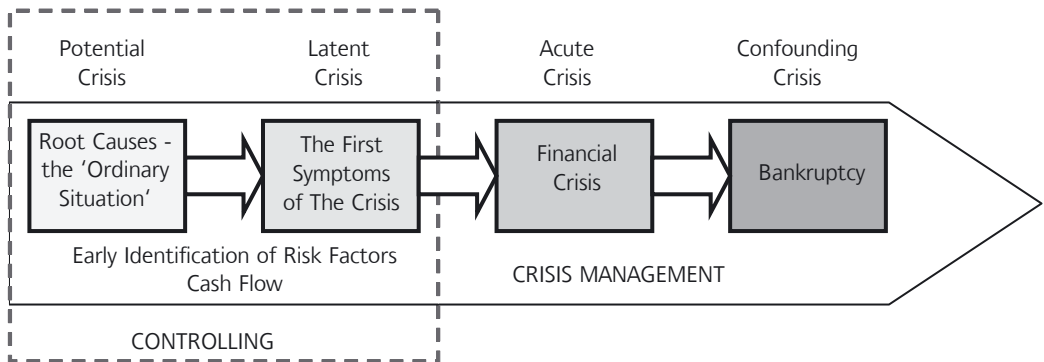


Figure 1. During the crisis in the enterprise

to be compared to the final preventive measures, which the company is able to perform. Creates a barrier and the last "rescue circle" before acute crisis take the place.

If the company has got problems with cash flow, then there are secondary problems, which are result from anything and reflect lack into non-financial field, which had happened in past and had not been resolved properly. Managing cash flow is a tool which switches on an orange light with a warning attention from and reflects something other than deficiencies in the financial sector that occurred in the past and has not been adequately or successfully resolved. Cash flow management is a tool, which work in exactly the amber warning "watch out".

The basis for successful management of cash flow is [13]:

a) Cash flow planning,

b) Knowledge of the factors that affect cash flow,
 c) Proposal of measures for deviations and their effective, timely implementation.

a) Cash flow planning

Planning cash flow for the enterprise is a tool not to fall into the company's inability to meet its obligations and is the basis for deciding on the allocation of available funds. Planning cash flow of the company enables

- To make clear transparency of financial flow within\out the enterprise and business development
- To manage cash flow in daily, weekly and monthly and long term basis.

Planning cash flow has operational activities in close connection to business planning in other

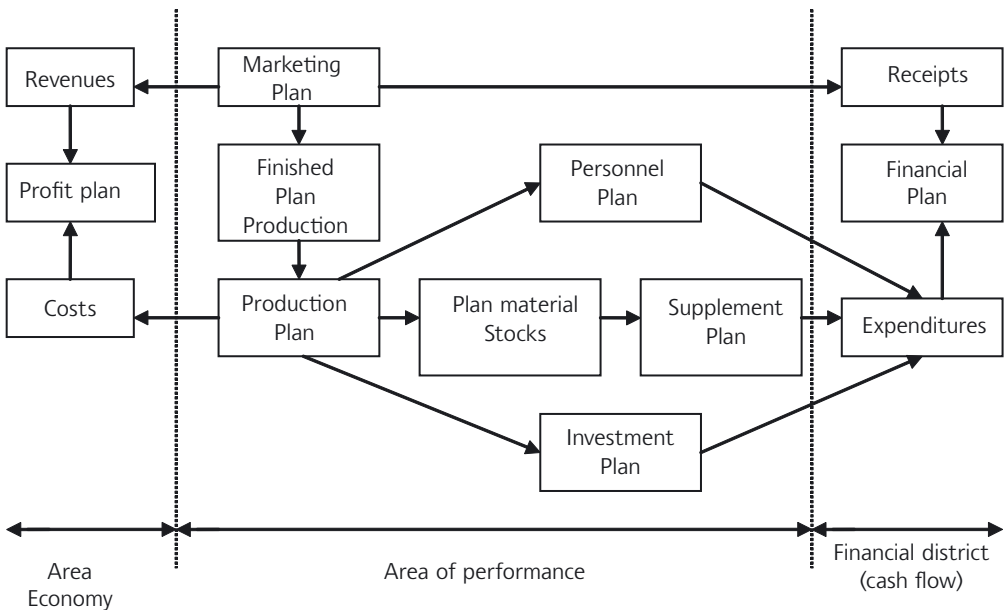


Figure 2. Relationship between intermediate operational business plans in terms of cash flow [3]

areas, particularly sales, production, procurement, human resources and investment. Interactions between business plans are in Figure 2.

Figure 2 shows that operational cash flow planning can not be an isolated activity by one worker or corporate field, but it is a close cooperation in particular production, purchasing, sales and other. Basis for operational planning is a weekly plan cash flow divided into individual business days. It is expected balance between income and outcome (outlay) the most important items for individual days.

Long-term strategies planning cash flow is mainly connected into technology investments, equity investments (purchasing of another shares of company) to develop a new product or technology and enter into new markets and so on. Each of these strategies is expensive, requires cost covering in the long term a it is risky. This has connection with future changes, which can not be predicted. [12]

b) Factors affects cash flow in business

Cash flow is an important factor which affects the overall value of the company particularly in terms of operating, investing and financial factors. Based on the correct plan cash flow of the plan cash flow is possibility to determine risk factors that most affect him in the enterprise. [8, 10, 13]:

- Common business activities and the payment cycle – eg, outstanding debts, late payments obligations, long production cycle, increase inventory in stock, decline in production, low quality products and using of technology, lack of innovation.
- Investments – eg. Wrong investments in marketing, production technologies, in product development, capital investment.
- External sources of funding – eg. The low

own reserves, problems with short-term loans, incorrect depreciation policy, decrease its own resources.

- Company cost – eg. Increase salary costs, increase production of prices, increase of material costs.
- Other inside factors – eg. Sales decline, weak management capacity, weak product portfolio diversification, lack of rationalization.
- Other outside – eg. Declining market share, intense competition, lack of resources, education level, etc.

One of the important factors which affects the level of company profit cash flow the ratio between the cost of product and sale price.

When an enterprise carries out several activities then should get into troubles. Lacks of sufficient information a direct costs must be spent on activity such activity is linked to indirect costs and which indirect (overhead) level costs and how they associated with activity. It turns out that it is ignorance of the costs of individual activities method in calculation of prices have a large impact on an insolvent of Slovak and Czech companies. [1]

c) Proposal of measures for deviations and their effective, timely implementation.

Proposal for solutions how to properly save its liquidation and the timely identification of risk factors cash flow should be the main focused on the following measures.

Reduction in current assets [4]:

- Shortly the financial situation could be compassed by reducing excessively high inventories at warehouse with finished goods.
- In the medium is necessary to start with measures to further reductions in inventories, as well as reduction in claims.

Reduction of fixed assets:

- For short term investment it is necessary to adjust the program as possible for the self-financing. The required reduction of fixed assets should be oriented downward trend became liabilities.
- Medium terms are necessary divestments (sale of fixed assets) as losses do not exceed the level of depreciation.

Restoration of viability:

Short term measures must be taken in order to reduce the level of costs.

- In the medium is necessary to embark on large-scale measures. It is necessary to get rid off unprofitable products.

3. Controlling - the system of early risk identification of in company

Effective system of early identification risks in company is controlling. Controlling in latent

crisis phase can identify early risk factors affecting the cash flow in all major areas of business which are most threat the survival of the company and they do not appear yet in field.

Controlling should be able to secure effective planning and control system with the necessary access to integrated business information. Controlling supports planning must be traced precisely to the revised planning process, which should provide more forward looking financial and economic indicators. Controlling to support inspection should compare selected variables already in the process and based on it can be made to fulfill these indicators and estimated time of the overall state of the enterprise.

Consequently comparisons of past, present, with the planned values in that space of time, which is still possible to take effective remedial measures to achieve the predicted parameters. It is called preliminary calculation i.e. flexible schedule where the comparison of the plan and so far known fact extended the comparison plan with respect to the future, the expected real development business.

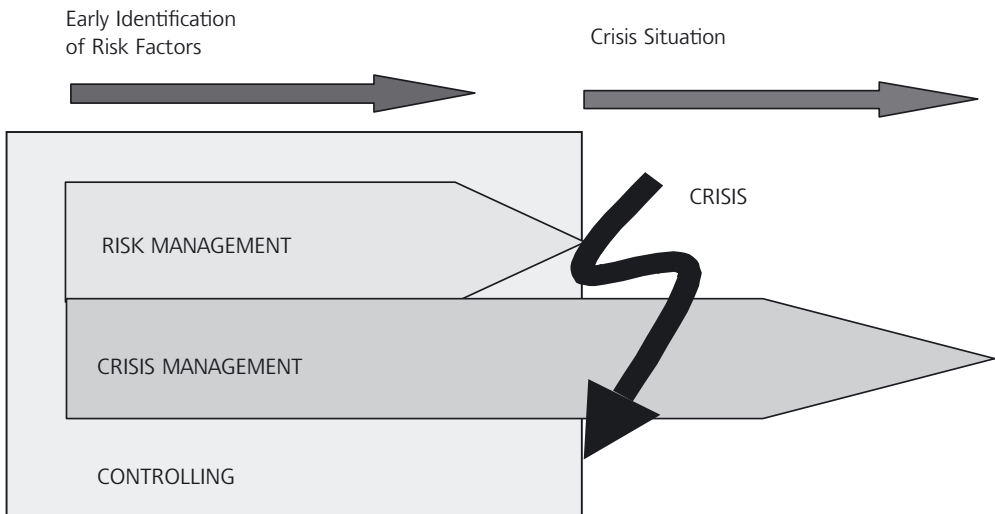


Figure 3. Controlling, risk management and crisis management

Optimal Controlling introduced, through, the integrated information on the findings of the first symptoms of abnormal development, in advance to recognize the risk factors affecting cash flow, identify and evaluate areas that are the main carriers of these risk factors, identify causes and pay attention to the danger of responsible managers in key areas of corporate governance in picture 3.

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