Using financial management to adopt long-term funding
Financial management analysis

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Abstract — In this article we tried to highlight the use of the financial management to optimize the decisional process of adopting the long-term financing. All the initiatives in the economic field are translated through an accumulation of financial resources and by creating an economic capital. The analysis of the financial potential follows the classical approach of a financial analysis. The inventory of the strengths and weaknesses of the company will serve as a basic construction plan. In terms of resources, the optimization of the decisional process of adopting long-term funding involves following the next stages: analysis of current financial structure; forecasting the needs of long-term funding; forecasting the funding sources on long term. The method use in this article lies in using the financial management with its indicators and in literature of specialty. In conclusion it is imperative to be taken measures both at microeconomic and at macroeconomic level for qualitative changes in the economic and financial mechanism to ensure the unblocking of the financial, informational and material flows of the economy.

Keywords- financial management; decisional process; funding; economy, resources

I. INTRODUCTION

The modernization and economic development, and the economic recovery can become reality only by investing. The long-term financing or, more specifically the financing of the investments is to promote a sustainable development of the enterprise. Such decision it is of vital importance and implies a huge responsibility it shows the name of long-term. The strategic nature of the decision to finance of the investments is emphasized by the following issues:

- long-term investment is a mandatory tool of growth;
- the investment absorbs a significant part of the enterprise resources;
- the investment decision has implications for several years and undertakes of irreversible manner the resources of the enterprise;
- the decision of investment will influence the environment of the enterprise, particularly financial

But this decision is complex, involving some difficulties related to:

- obtaining digital information that characterizes the investment project which presents interest;
- application of certain financial calculations (cost of capitals, financial structure, analysis and evaluation);
- risks associated to each investment project;
- coordination of applying the investment decisions across the enterprise

The investment means to sacrifice a little in present for more in the future. Despite all difficulties, it is justified in terms of profit and generally, by its contribution putting into practice of the long-term objectives of the enterprise, and the ensemble of these major objectives, along with the resources ant deadlines, according to the company’s mission is just the company’s strategy.

The investment decision is the core of long-term financing strategy, which cannot ignore the company’s global strategy. The managers must approach the investment problems through the prism of global analysis, at the enterprise level. Thus, the objectives which are at the basis of investments must be interdependent with those established through the general strategy of the enterprise.

The long-term financing decision are more reduced ad number, but the objective of each strategic decision of an economic agent is ultimately financial, because any future orientation of the enterprise’s activity has a final purpose the cover of the expenditures from own incomes, ensuring of a efficiency in continues growth.

In a market economy, all the enterprises endure two constraints in terms of investment:

1. profitability, necessary condition of survival and more so for development;
2. Limitation of the financial resources

II. THE METHOD

The decision of investment involves the acceptance of a risk that the flow of future incomes corresponding to the investment to be inferior to the one forecasted and that these revenues not to cover the initial cost, in other words, the cost of investment.
If despite the inherent risk of all investments it is decided if, however, to invest, it arises the problem in what extent and how accurately it can be determined the profitability of investments. If it would be possible the classical procedure of determining the profitability of investments would be enough.

Theoretically this implies the elimination in a first phase of unprofitable or unsuitable investment projects from the point of view of the firm’s strategy, based on using a set of criteria for assessing the investments:

- profitability rate of the invested capital;
- the investment recovery period;
- net current value;
- internal rate of profitability;
- multi-criteria analysis

These calculations are based on forecasts, which due to the dynamic character of the economic processes, are becoming questionable.

The practice shows a different assessment of investment projects is absolutely necessary but not sufficient, at least on long-term. This is because in the most of the real situation, in the moment of starting investments only a part of the elements that affect the profitability are known, the rest can be appreciated in imprecise terms.

It is arisen the problem of establishing the real profitability of the investments. A way is to assess the average rate of profitability, at which the developer can expect in the sectors in which the enterprise is operating, with the specification of the superior and inferior ceilings, for the case of success, respectively by average results, taking into account by the general characteristics of the economic and financial environment. To this end, the forecasts will have at base the calculations of past and present profitability, on the sectors that are interesting the enterprise. Starting from these data, the company will select the values of profitability rate that will try to touch them in the respective sectors. Anyway, the company management must be prepared for all the possibilities and even for the impossible.

Regarding the resources, the optimization of decisional process of adaptation of financing on long-term involves walking through the following steps:

1. Analysis of the current financial structure;
2. Forecasting the long-term financing needs;
3. Forecasting the long-term financing needs

III. RESULTS AND DISCUSSION

The future ways of funding and destination of the money funds will depend inevitably by the current financial structure and more precisely the way in which the management of the enterprise has managed so far to achieve a financial balance or not. Ensuring the financial balance, both on long term and short-term, is a prerequisite for development and especially for the company’s survival. Since the working capital is one of the most representative indicators in the expression of the long-term financial stability, the analysis of the financial structure will involve comparing the working capital with the need of working capital.

The existence of a higher working capital then the need of working capital is translated through a surplus of permanent capitals, which can be used by the enterprise to finance the different projects on long term. The existence of a working capital inferior to the need of working capital is translated through a shortage of permanent capitals, which involves from the company’s part a revision and restore of the financial structure. In other words, contrary to the principle of financial management, the enterprise used a part of the temporary sources to finance some permanent needs.

IV. FORECAST OF THE FUNDING NEEDS ON LONG-TERM

The most pressing problem related to investments is the one of financing constraint, given that the needs are infinite, while the resources are limited. The financing needs will be appreciated only if after preliminarily were eliminated the inappropriate projects. To this end it is made a hierarchy of the investment projects according to the strategic objectives of the enterprise, based on the use of a set of assessing criteria of the investments:

- profitability of projects;
- the risks associated with projects;
- links with the existing activities
- the urgency degree of the investments

When forecasting the future need for long-term financing, secured from permanent capitals, there must not be forgotten the needs related to the previous operations, especially the annuities proper to the previous working capital, and the eventual reconstruction of the working capital so as to exceed the need of working capital.

A program if investments may have a better forecasted profitability, but at the same time to train unacceptable financial needs. It is sufficient a gap between expenditures and revenues.

V. FORECAST OF THE FUNDING SOURCES ON LONG-TERM

The funding sources on long term at which are having access all the economic agents can be grouped as follows:

- Internal sources: self-financing; disinvestments;
- External sources: bank loan, leasing

VI. INTERNAL SOURCES OF LONG-TERM FINANCING

The most “handy” internal source of financing for any economic agent is self-financing.

Self-financing is the only resource separated by the enterprise itself, contributing to the continuous supply of the working capital. The self-financing consists from resources generated even by the exploitation activities and reserved for financing the investments of renewal and development, maintaining the production potential, maintaining the
market share, covering the risks, etc. To establish the degree, in which the enterprise is in measure to self-finance its investments, is started from the calculation of self-financing capacity.

Self-financing = CAF – Dividends

To determine the possibilities of self-financing involves, therefore, the establishment of the level of self-financing capacity, from which there will be deducted the incomes proper to the shareholders at the enterprise’s capital.

The self-financing advantages are:
1. Self-financing ensures the financial autonomy of the enterprise, which allows the flexibility of the decisional act. Thus, the company’s management may have in any moment by the available resources. Without being pressed by the external control concerning their use;
2. Self-financing is a funding source necessary both to ensure the company’s stability, both and to enrich through the contribution at the development finance;
3. Self-financing allows to avoid some substantial expenditures from financial operations, related to the borrowings, in the case of using them and of the interests;
4. Self-financing is a guarantee, an indispensable complementary element in granting the loans on long-term. The lender will never agree to finance the ensemble of enterprise’s needs, taking into consideration the inherent risks. He will ask the enterprise to cover a part of the risks by using the self-financing.

The disadvantages of self-financing can be:
1. The biggest disadvantage is that the self-financing is apparently free. This is reflected in the negligent approach from the part of the decision-makers of selecting the investments. In reality, the self-financing involves some costs: a cost of the interest, meaning that the money funds being the self-financing could be placed in banks. It is itself about a cost only of the practiced interest is superior to the investment’s rate; a cost of profit, because the company seeks to increase the margin of benefits, to release a significant saving, which is reflected in the reduction of total profit; a cost of the capital, because the company’s management tends to reduce the dividends to increase their wealth, at the detriment of shareholders.
2. In some conditions, using the self-financing is equivalent with slowing the progress of the company. Choosing the self-financing, as only source of funding, the enterprise is found in the inability to cover the investment needs. This means that not having external means, the chosen variant by the company’s management will focus or investment of modest size, or to reschedule the expenses over a long period. In addition, there is the risk that by delaying the time of investment, the enterprise to permanently loses opportunities of the moment.
3. From a macro perspective, the main criticisms brought to the self-financing concerns the aspect of income distribution in against the favor of third parties (customers, employees, shareholders) and the fact that maintains the saving in a sector of the economy.

The disinvestment is another way to obtain financing resource from internal sources, required to conduct the investment programs of to increase the working capital in the case of its insufficiency.

The principle which is at the base of the divestment is the one of disposal of fixed assets, which they are in the enterprise’s property (for example, lands, buildings), in return for which the company receives money funds, which it can reinvest them in different activities, concerning other markets or products. Also, the enterprise may resort at selling titles of participants or other assets, with the condition that such operation to not put in danger the asset.

The advantage of the divestment, consists in the fact that the resources are coming from real estate are free financing sources, by inference of the tax, with the exception of possible plus-values, which are taxed. In the extent in which the disinvestments do not reduce the enterprise’s potential, but are allowing, on the contrary, acquiring new means, such as to facilitate its adaption, these internal resources are more useful to the enterprise, allowing him to reduce the external aid.

VII. EXTERNAL SOURCES OF FINANCING ON LONG-TERM

If the company adopts a policy if development, it often happens that the internal resources to be insufficient to secure funding the investments program, which involves appealing to external resources, mainly from long-term bank loans.

The advantages of long-term bank loan
It is a viable financing alternative, that allows the company to cover its funding needs relatively quickly, in the measure in which the necessary formalities to be fulfilled by the one that requests the credit, guarantees, bureaucracy isn’t from the economic agent’s point of view respectively, major obstacles that to stop the investment enthusiasm; Resorting to sources attracted, the enterprise can increase its profitability of the invested capital, in the conditions of the existence of a rate of economic profitability superior to the interest rate (the leverage effect).

The disadvantages of long-term bank loan
The enterprise which receives the loan bears a considerable increase in financial expenses,
Advantages of leasing are:

reason being the high cost of such financing arrangements. Regarding the financial structure, the banks conditions granting the loans on long-term on the amount of the own capitals.

Another limitation imposed by banks aiming the financial structure, has in view to quantify the rate of financial independence, determined as a report between the own capitals and total passive, rate that can’t be below 20% (but it is prudent to be between 25-30%)

It can be said that the choice between the financing through own capitals and using to indebtedness is more theoretical, since there are a number of limits in the way of indebtedness.

The leasing, although it appeared in the U.S in the 50’s, as effect of accelerating the technological progress which trains more rapid renewal of the goods becoming more expensive, in Romania this it is still in “infancy”. The economic agents don’t “crowd” to use the leasing, even if it is introduced and regulated by several years, the main reason being the high cost of such financing arrangements.

Advantages of leasing are:

1. From the financial standpoint, the leasing is an operation that does not change the company’s financial structure. It does not change the report between indebtedness and own capitals and thus leaves the possibility to resort to loans. The leasing defends, mainly the tenant’s credit;

2. The leasing is a development and progress factor. Indeed, the technical development is often broken by the narrow limits of the available funding means. This situation results most often from a saturation of the indebtedness capacity because of the insufficiency of own resources.

3. From fiscal point of view, the leasing involves only deductible expenses (including rental costs)

4. The leasing is a very flexible form because the cost is closely related to the use of the leased asset. The grace of the leasing contract allows the adaptation to each situation and distribution of period payments according to the objectives of the enterprise.

The main disadvantage is the high cost of this operation. Even if it bears comparison, in certain situations, with another ways of funding and particularly with the credit on average term, the leasing procedure is more expensive.

Also, the note holder loan allows the enterprises to plan their increases of funds on long term through stable resources, which are increasing the working capital in risk conditions. The major inconveniences related to the bond loan are viewing the complicated formalities and restrictive access, conditioned by the ensuring by the enterprises of commitments to the public.

VIII. CONCLUSIONS

All the initiatives from the economic domain are translated by an accumulation of financial resources and through the creation of an economic capital. This is why the financial forecasts often express the company policy.

There is often the temptation to assimilate the development plan of the enterprise with the financing plan. In reality, despite the specific of the financial act, the funding plan it is not the expression of the development plan of the enterprise, with the main strategic components: industrial, commercial and human. Its knowing is primarily to the understanding of the place and role occupied by the funding plan in obtaining some dynamic growth.

The planning process is the consequence of the intercession of alternative type in the manner of exploring the possible various ways of development for the enterprise. The option is still limited, on one side, by the enterprise’s potential, and on the other, the objectives fixed and opportunities that it is having.

The preliminary analysis of the potential follows to achieve of the means inventory which is having the enterprise in plan: industrial, commercial, human and financial. This decomposition according to the four functions of the enterprise will be used extensively in the planning process.

The analysis of the financial potential follows the classic approach of a financial analysis. In the optic of the plan, it aims to determine the capacity of indebtedness, taking into account by the level of own capitals and by the enterprise’s objectives. This inventory of the strengths and weaknesses of the enterprise will serve as base in the construction of the plan. The plan will have as target the adaptation of means and objectives to a defined general policy. It is about the available initial potential which will come to help the new means necessary to change the size of the company. There are certain limits that the company cannot exceed in the acquisition of means, without threatening its balance.

The constraints specific to financial life of the enterprise can be satisfied based on different paths. These methods depend on the followed objectives, which are the financial policy (funding plan). The organization conditions of the financial restrictions at balance and profitability are chosen by taking into account the achievement of the objectives set by the company. These are not the same as the company pays more or less importance to its autonomy or is more or less oriented towards a domination policy of the market.

It is still necessary to be taken measure both at microeconomic and macroeconomic level for qualitative changes in the economic and financial which to ensure the unblocking of the material, financial and informational flow from the economy
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