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BUSINESS FINANCE NEEDS AND DECISION-MAKING FACTORS

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Abstract: Ensuring the efficient management of the company's activity and obtaining the expected results entail the elaboration of a financial policy oriented towards attracting own and borrowed financial resources from various sources. The financial policy aims to ensure a necessary level of self-financing. The need for financing, but also the real possibilities for attracting financial resources are not the same for all the entities, being conditioned by a series of factors. The study of the factors of influence and their administration ensures the determination of the financial cycle and guarantees a financial balance between the needs and the sources of financing of the enterprise.

Keywords: *financial management, financial policy, need for financing, networking capital, required working capital, financial cycle, operating cycle, turnover ratio*

I. Net Working capital and decision making

In the process of economic activity, the biggest fluctuations appear, as a rule, in the operational activity of the enterprise, thus, the financial management aims to ensure a balance between temporary needs and temporary resources. The indicators related to working capital, namely the required working capital, can characterize this state of equilibrium.

The net working capital characterizes the way in which current assets are funded from stable or temporary sources.

NWC = CA - CL (1)

where:

CA– Current assets

CL – Current liabilities

In relative size, working capital characterizes the extent to which current assets are covered by permanent sources.

$$\text{NWC } (\%) = \frac{\text{NWC}}{\text{Sales}} * 100\% \quad (2)$$

The working capital requirement designates the financial needs generated by the performance of repetitive operations that form the operational cycle, the total of which shall be covered, at least in part, by stable sources[1].

NWC = Inventories + Receivables - DC (3)

where:

NWC – required working capital.

[1] Petrescu S. Analiză financiară aprofundată, Concepte, metode, studii de caz. https://www.academia.edu/31023701/ANALIZ%C4%82_ECONOMICO_FINANCIAR%C4%82. p.128

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This indicator plays an important role in the financial management process, as it allows to determine the required volume of bank loans.

NWC in relative size can be determined by the following formula[2]:

$$\text{NWC} = \frac{\text{NWC}}{\text{Sales daily}} * 100\% \qquad (4)$$

This ratio reflects the current account deficit in relation to the annual sales volume.

The need for funding [2], but also the decision of financing enterprises, influences a number of factors, among which the most important are:

1. Type of activity
2. Enterprise size
3. The financial cycle
4. The level of profitability of the business
5. Business risk level
6. Manager qualification level
7. Conditions of capital bidders
8. Financial market stability

In their turn, the factors can be divided into factors that can be controlled by the company (the first six) and factors that cannot be controlled, or more difficult to control (only if the company has a dominant position in the market, it can impose certain conditions that are also observed by the other competitors).

II. Decision-making factors

(1) Business areas activity, source of financing and needs

The financing needs of the company mostly depend on the type of activity, on the branch characteristics in which the company operates. The specificity of the activity, the particularities of production, the process of sale determine the financing needs, the deficit or the surplus of liquidity, create obstacles or, on the contrary, facilitate access to certain financial funds.

For example, agriculture is a major and important branch of the economy of any state, regardless of its level of development. The peculiarities of agriculture are that the development of this branch is conditioned by a number of factors such as climate, economic, technical and human, innovation and information. Starting from the premise that agriculture shall provide the necessary food for the population of a state, government policies include all the necessary conditions for the development of this branch. Due to the fact that those enterprises are organized in the form of joint-stock companies, limited liability companies or sole proprietorships, operate on the principle of self-financing, however, without state support it is difficult for them to survive. Thus, in order to support agricultural enterprises, the following financial measures are defined:

- Creation of special funds for financing agricultural enterprises (subsidy);
- Compensation for some expenses (electricity, fuel);

[2] В.В. Бочаров Современный финансовый менеджмент. СПб.: Питер, 2006. — 464 с.: ил. — (Серия «Академия финансов»). ISBN 5-469-01134-8

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- Leasing contracting with the participation of the state, etc.

At the same time, we emphasize the fact that agricultural enterprises are constantly facing a deficit of liquidity, given the fact that the production process is a long one.

Unlike agriculture, in which the state is a partner, in the field of construction, part of the financing of the works belongs to the customers. Thus, as another example, we mention the field of constructions, in which the financing is made on the basis of the budget established in agreement between the client and the executor of works, as well as on the basis of agreements with the suppliers of construction materials. The construction activity is characterized by a longer financial cycle, which influences the volume of production in progress, covered by current assets. Therefore, in the structure of current assets, the largest share belongs to the production in progress. In contrast to other branches, as well as in trade, the period of the financial cycle is the shortest. At the same time, the structure of long-term assets and current assets differs compared to their structure in the other branches, current assets having priority. This structure determines trading companies, companies for provision of services, to give priority to short-term sources of financing (Table 1).

Table 1

Sources of financing of enterprises by type of activity

2020	Total equity	Long-term debt	Current debts	Working capital, %
Agriculture, forestry and fishing	38.65	28.14	33.18	22.06
Food industry	35.74	19.11	45.15	22.60
Constructions	30.79	28.58	37.64	45.42
Wholesale and retail trade	36.84	15.86	47.12	35.33
Information and communications	50.42	23.90	23.78	22.76

Source: Developed by the authors based on the data of the National Bureau of Statistics of the Republic of Moldova

According to the data in Table 1, the largest share of own sources is in enterprises in the field of Information and Communications, i.e. over 50%. The significant share of equity, but also of long-term debt allows us to conclude that these companies do not face difficulties in financing the operational activity. The opposite is true for food and trade enterprises, which are largely dependent on current funding. At the same time, it should be noted that, although for other companies the share of permanent sources of financing is lower, it covers a larger share of current assets. For example, in constructions, the share of permanent capital is 59%, compared to the field of information and communications, where it is 74%, but the level of coverage of current assets with permanent sources is 45% compared to 2.3%. This situation is conditioned by the particularity of the branch and argues a lower need for temporary sources of financing within the enterprises in the Construction branch.

According to the National Bureau of Statistics of the Republic of Moldova, the most credited branches of the national economy are agriculture, retail, industry and transport and storage services. In these branches, the share of credit beneficiary enterprises is higher than the average for the economy (higher than 70%). At the same time, among the least credited branches of the economy is that of information and communications and hotel and restaurant services, where the share of enterprises receiving loans is less than 70%[3].

[3] National Bureau of Statistics of the Republic of Moldova

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(2) The size of the enterprise and financing need

The financing needs, but also the financing possibilities mostly depend on the on the size of the enterprise. On the one hand, large enterprises have real opportunities to increase their own capital and finance their activity from their own sources, and on the other hand, small and medium-sized enterprises enjoy the financial support of the state, which reduces their need for funding, as confirmed in Figures 1 and 2.

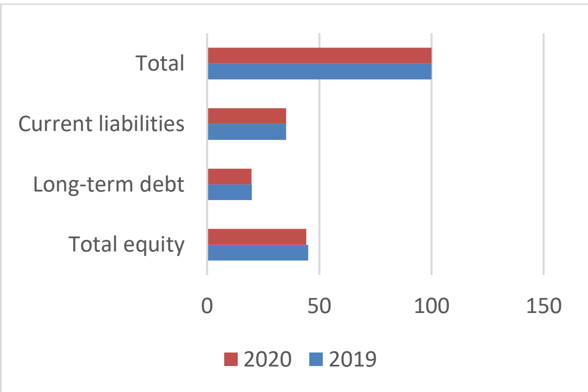

Diagram 1. Financial structure within large enterprises in the Republic of Moldova

Source: Developed by authors based on data of NBS[4]

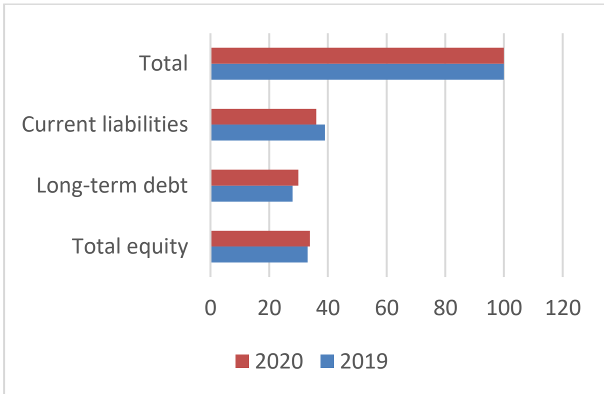

Diagram 2. Financial structure within small and medium-sized enterprises in the Republic of Moldova

Source: Developed by authors based on NBS data

Diagram 1 illustrates a high share of equity in the structure of financing sources in large enterprises in the Republic of Moldova. This situation can be explained by the high possibility of obtaining profit and its subsequent use. As we can see, the short-term financing sources are on the second place in terms of preferences, which allow companies, if used correctly, to optimize the financing cost.

On the other hand, as preferences in the selection of funding sources, there are small and medium-sized enterprises, that are financed primarily from short-term sources. At the same time, long-term borrowed sources remain the least preferred, as in the case of large enterprises.

If large enterprises opt for their own financing compared to loans in order to have control over the business, then in the case of small and medium-sized enterprises the problem lies in the limited access to these sources of financing. Moreover, the high share of current debt does not imply a classic financing, i.e. contracting loans or concluding financing contracts. Next, we look at how the current financing requirement changes depending on the size of the enterprise (Diagram 3)

4 *The information is prepared by the head office of the parent company. The information is presented without the data of the districts on the left side of the Dniester River and Bender municipality*

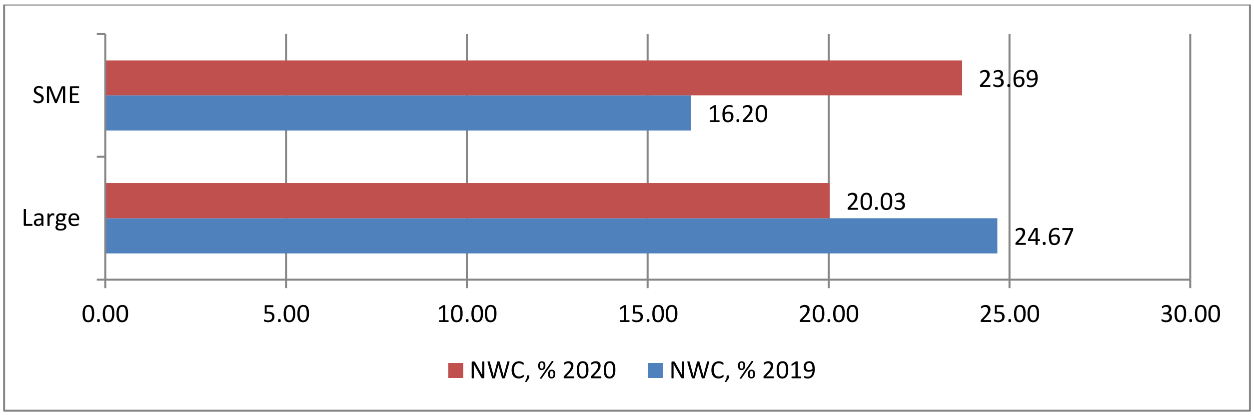

Diagram 3. Need for working capital in large enterprises and SMEs in the Republic of Moldova
Source: Developed by authors based on data of NBS

Diagram 3 shows a close level of working capital requirements for large enterprises and SMEs in the Republic of Moldova. A level of 20% indicates that companies face a shortage of working capital in the amount of 1/5 of annual sales revenue. In other words, 73 days a year (1/5 * 365) companies work only to cover their current needs. The lowest need for temporary resources is contained in small and medium-sized enterprises in 2019, namely 16.2%.

For a better understanding of the need for financing, it is recommended to determine the period of rotation of the elements that contribute to the determination of the necessary working capital, elements that characterize the operational and financial cycle of the enterprise.

(3) Financial cycle

For financial managers, it is important to know not only the amount needed to finance the current activity, but also the length for which they will be enough. For this purpose, the level of the financial cycle is important.

The financial cycle (FC) is the period between the time of payment of the raw material, the goods to the suppliers and the time of collection of the value of the goods sold from the buyers (figure 1).

$$FC = DIT + ARTR - APTR \quad (5)$$

or

$$FC = OC - APTR \quad (6)$$

where:

OC - operating cycle, days
DIT – Days inventory turnover
ARTR – Accounts receivables turnover ratio
APTR – Accounts payables turnover ratio

Therefore, the length of the financial cycle is directly influenced by the inventory turnover, receivables and accounts payables. Thus, in order to reduce the financial cycle, it is necessary either to reduce the turnover of inventories and receivables or to extend the turnover of accounts payables. The ideal, equilibrium situation can be recorded when the length of the financial cycle is equal to "0". However, this is only possible if the period of the day's inventories turnover and receivables is equal to the accounts payables turnover.

Figure 1.

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The interdependence between production cycle, operational cycle and financial cycle

Production cycle		*Days accounts receivables*
Operational cycle		
Days accounts payables	**Financial cycle**	
	Days inventory turnover	

Source: Elaborated by authors

In order to optimize the period of the financial cycle, the Enterprise (Business) undertakes all possible measures to reduce the period of accounts receivables ratio or to pretend for a shorter length of the receivables ratio than the accounts payables turnover. For the achievement of this result, the enterprises can sell their commercial invoices with a discount to the factoring companies. In the result, the decrease of length of the financial cycle influences both, the necessities of temporary financing, level of profit, and the risk related to enterprises' activity.

The length of the financial cycle varies from one branch to another, moreover, this can vary also from one enterprise to another, being conditioned by several causes, of which:

- Differences in provisions of collection policies and payment of debts.
- Schedule of supplies / payments / receipts. Often the gap between supplies and production achievement causes a greater need of financial resources.
- The volume of activity. The dynamic growth of production implies greater investments in inventories and, respectively, greater financing needs.;
- The competitiveness, which requires the permanent existence of a safe inventory of both, raw materials and finished goods, in order to meet the consumer requirements.
- The size of enterprise;
- The origin of goods (if they are own or purchased production).

The accurate management of the financial cycle is very important because an extended interval of the financial cycle can have the following consequences:

- additional expenses (in the form of penalties for non-payment on time);
- the credibility of the enterprise (business) is affected and future loans will be contracted on less favourable terms;
- if the length of financial cycle has been negatively influenced by the number of days of the receivables collection, then delays may also occur in supplies, which affects the profitability of the business.

The length of the financial cycle depends on several factors of interdependence. Analysing only the influence of two factors and namely: size and type of activity (Table 2 and table 3).

Table no. 2

The financial cycle in the large companies of the Republic of Moldova, days

Large activities	DRS		DRC		DRD		DCF	
	2019	2020	2019	2020	2019	2020	2019	2020
Agriculture, forestry and fishing	147.63	126.49	235.10	196.13	323.31	252.86	59.42	69.75
Food industry	75.87	110.11	126.78	112.29	152.85	170.50	49.80	51.90
Constructions	185.37	219.56	111.11	112.01	205.90	223.55	90.58	108.01

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Wholesale and retail trade	49.50	67.50	79.21	72.04	96.96	96.96	31.74	42.58
Information and communication	17.61	17.75	80.12	76.42	115.12	108.20	-17.39	-14.03

Source: calculated by the authors based on the data of the National Bureau of Statistics of the Republic of Moldova [3]

The analysed data denote that the length of the financial cycle (FCL) is longer in the field of construction and agriculture. Regarding the finality of production cycles and of operational cycle, the bigger probability that these will not be completed is in agriculture. This is caused by multiple natural hazards that can affect crops or animal husbandry, risks that often cannot be controlled by humans. In these conditions, agricultural enterprises will not be able to convert, for example, seeds into crops and thus recover the cash used to procure the raw material.

The shortest length of the financial cycle is in the field of trade. The negative result of the length of the financial cycle for Information and Communications fields does not characterize a financial cycle as such, but it does mean that Information and Communications fields have sufficient own resources to fund the operational activity, moreover, they could also finance other businesses. This situation is explained by the fact that most companies in this area sell their services in advance (for example, customers pay in advance for mobile subscriptions, internet), but payments to suppliers take place at the end of the month. In these conditions, the enterprise has access to financial resources before the maturity of their debts. At the same time, we have an increase in the size of financial cycle over the last few years, in all branches, this fact indicates inefficient management of the company's working capital, which negatively affects the company's credibility and reduces its funding opportunities.

Table no. 3

The financial cycle in small and medium enterprises (businesses) of the Republic of Moldova, days

Small and medium enterprises	DITR		DART		DAPT		FCL	
	2019	2020	2019	2020	2019	2020	2019	2020
Agriculture, forestry and fishing	126.13	154.77	137.82	151.98	224.86	272.17	39.09	34.58
Food industry	80.63	94.12	78.59	80.95	189.92	198.29	-30.69	-23.22
Constructions	173.37	195.96	176.43	196.28	259.19	259.65	90.60	132.58
Wholesale and retail trade	94,38	105.51	101.81	94.38	164.77	166.25	31.42	33.65
Information and communication	17.09	19.89	92.53	86.41	150.02	134.92	-40.40	-28.62

Source: calculated by the authors based on the data of the National Bureau of Statistics of the Republic of Moldova

There is a slightly different situation in the small and medium-sized enterprise sector. A positive evolution we see only at small and medium-sized enterprises from the agriculture field, at which the length of the financial cycle decreases, which demonstrates that enterprises (businesses) will need fewer loans to finance their day-to-day business. The enterprises (businesses) from Food Industry and that of Information and Communication do not express difficulties in the financing of current activity, in other words these don't need temporary resources of financing.

Often, small and medium-sized enterprises, due to lack of financial resources, do not meet certain obligations in a timely manner and this results in an increase of current debt. For example, the postponement of the payment of salaries can affect the quality of work, or even stop the production process, which therefore affects the period of the financial cycle, in the sense of it increasing. (Figure 2).

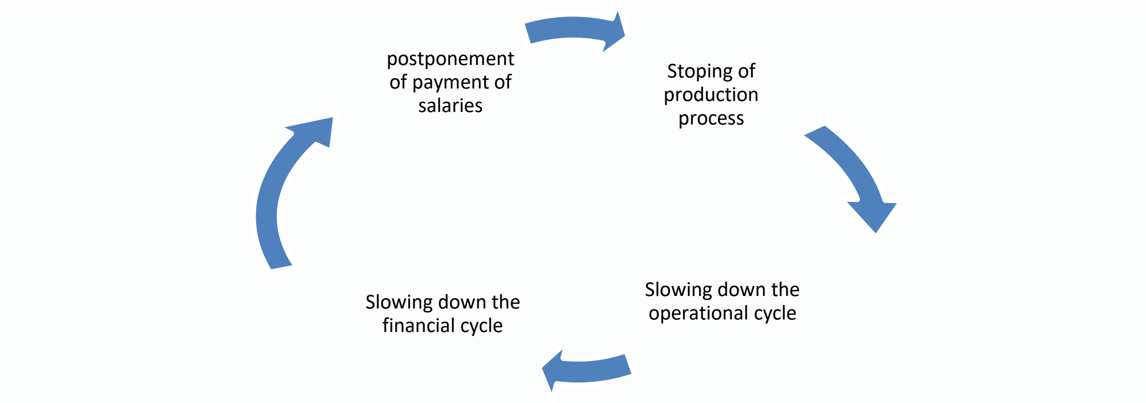

Figure 2. The interdependence between the postponement of payments and the length of the financial cycle
Source: Elaborated by authors

Thus, in order to effectively manage the financial cycle, the enterprise can resort to the following measures:

- judicious control of inventories of goods and materials, namely the control of all phases: supplying, production and sale;
- the selection and acceptance of the customers who enjoy postponement of the payments only after a detailed analysis of their financial situation. At the same time, the enterprise must use, where appropriate, all possible instruments for the time or before the term collection of commercial invoices.

For evaluation of the payment's capacity of the customer can be used the method of those 5 C: capacity, character, capital, collateral, conditions. Thus, the customer should be analysed under all these 5 aspects:

1) if the customer has the ability to pay and pays on time;
2) character (credibility) of the customer;
3) the customer may or may not have sufficient own capital, namely financial stability;
4) the seller may require payment of part of the invoice as security for the transaction;
5) the conditions of sale by credit offered by the other competitors must be analysed.

It is important to mention that the maximum effort must be made to pay the invoices at maturity, as this will directly affect the length of the financial cycle, but also the enterprise's ability to pay its obligations to suppliers and creditors. The non-expired invoices can be converted into liquidities by selling them to factoring companies. In this way, enterprises can cover some of their short-term financing needs.

(4) The level of profitability of the business

The reduction of the period of the financial cycle (FC) influences both the financing necessities and the level of profit of the company. The increase of the profitability, but also of the profit in dynamics

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allows the increase of the own capital and therefore reduces from the needs in temporary resources of the enterprise.

(5) The degree of business risk

The risk and profitability are key elements characteristic for business environment. If the profitability positively influences on the financing possibilities, respectively a higher level of profitability offers the possibility of obtaining of some more advantages conditions regarding the financing. The risk, namely its increase, will have a negative influence on the financing possibilities of the enterprise. The progress of economic risk will result in the growth of financial risk, and in the result the increase of period of financial cycle All these events produce an insufficiency of financial resources.

(6) Qualification level of managers

The financing possibilities of the enterprise, the need for temporary financial resources, but also the financial condition of the enterprise depend to a large extent on the level of training of the managers who manage it. Here it is important to delimit the enterprises: large, medium, small and micro. If within the large and medium-sized enterprises exist a qualified administrative staff, financial subdivisions, then within the small and micro-sized enterprises, the activity is managed, only by two persons (the owner and accountant). Thus, decisions that are taken in small and micro enterprises do not go through several stages of analysis and approval, as in large and medium-sized enterprises. These decisions, taken promptly, are often based on emotion or intuition and can have a negative impact on the entire operational activity and therefore on the need of enterprises' financing.

The conditions of the capital tenderers and the stability of the financial market may more or less affect the financing needs of the enterprise and, respectively, the financing possibilities, depending on how the factors analysed above control its enterprise.

III. Conclusion

From the multitude of factors that influence the financing needs of the enterprise, the most important is the financial cycle, the length of which depends not only the real financing needs, but also the level of profit registered by the enterprise. In turn, the period of financial cycle depends on a number of interdependent factors, which, being correctly managed, will reduce from the needs of enterprises' financing, but, at the same time, will contribute also to the reduction of some expenses as penalties for no-payment in time of obligations, and in the result will contribute to the creation of a good reputation of the enterprise. In the pandemic context, the enterprises shall closely monitor the receivables and to ensure that is preserved a control discipline of the customer – credit and of debts, so that the delayed payments will not be transformed into non-performed debts.

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