TRANSITION IN FINANCING A COMPANY AS WAY TO PROSPERITY

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The aim of the article "Transition in financing of a company as a way to prosperity" was to asses the overall financial condition of a particular company, and after the performance of detailed analysis to advise on how to optimise the company´s financial struture in order to achieve better results overall. It analyzes the alternatives, methods and forms of business financing, trying to asses the optimal structure of assets, and advise the optimal financial structure given the art and nature of company´s business as a result financial analysis based on the information available. The final section, then, summarizes the best practices and formulates recommendations on how to improve financial stability and efficiency in a particular company.

Key-words: finance, finance transformation, financial analysis, prosperity

1 INTRODUCTION

The evaluatinon of the company´s performance should primarily be based on analysis of available resources and their use while applying the overall acceptable rules on financial structure. The change in financial structure is about the application of those rules in a particular environment in order to achieve a more appropriate structure of financing and in this way to improve the existing situation. The change in financial structure should ultimately lead to higher dynamics; positive development and greater prosperity of the company in question.

2 THEORETICAL ASPECTS OF FINANCING

Funding can be seen as capital procurement,or the acquisition of capital necessary to start and run the business. As each sort of capital used has a different characteristics (cost of capital, maturity, acquisition risk, limitations to distribution, change of ownership et.) it is very important to decide on optimal capital structure before the capital acquisition itself. The possibilities of funds acquisition may seem endless today, but may therefore bring both, advantages and confusement. An enterprise can be funded through several combinations of equity and foreign capital, internal and external sources, long-term and short-term capital, and actual mixture of these resources may vary in time as the company experiences its own lifecycle. Everyday business decisions should therefore include decisions based on analysis of current financial situation of the company and analysis on possible necessity to change the financial structure. This includes detection and identification of both, the strengths and weaknesses of company´s business and finanvial resources in use.

2.1 Financial Structure of the Company

Wide range of financial resources can be used to finance a company. In order to make the analysis easier, the high variety of financial resources may be grouped by different aspects.
The most common used are:

- financial resources grouped by purpose
- financial resources grouped by ownership
- financial resources grouped by their maturity
- financial resources grouped by their sources
- financial resources grouped by their application time.

2.2 Methods of financing the business

There are several ways how to finance the company, but the most common decision inludes the one based on sources of funding:

- funding equity (share issues, contributions in kind),
- foreign capital financing (bank loan, business loan, loan, bond, deposit supplier)
- self-financing (financing profit, depreciation and other internal resources.

2.3 Methods of Assets Acquisition

Assets can obtain in a variety of ways:

- By purchase
- Through donation
- Internally through activation of own production
- conversion from personal use to business (asset input).

2.4 Forms of financing business

Selection of the most effective form of business financing is a very important task for the company. The following table shows the most common forms of financing:

Origin of capital / Kind of kapital	Internal sources of funding	External sources of funding
Own resouces	Profit, depreciation, retained earnings, funds from profits, deferred tax reserves, sale of assets of the company, other internal resources, some specific forms of financing (leasing, factoring).)	Shareholder Deposits; silent stake partnership deposits, capital investments, equity investments
Foreign surces	Non-repayable loans, unpaid taxes and contributions, employee liabilities, liabilities to the State, other resources (funds)	Supplier loans, advances received, loans - long-term and short-term grants, gifts, leasing

Tab. 1 Forms of financing capital
Source: Own processing

3 CHANGE OF COMPANY´S CAPITAL STRUCTURE

The concept of financial transformation includes group of financial decisions that result into change in capital structure of the company while business itself remains unchanged.
With a certain degree of simplification, changes in the capital structure can be characterized by sources of funding which resulted in overall changes.[1]

3.1 Changes in financial structure based on equity

Changes in equity include a significant amount of specific financial decisions:

- Allocation of profit to the company reserves
- Use of profit funds
- Use of reserves to increase capital
- The conversion of registered capital to reserves
- Conversion from ordinary shares to preferential
- Conversion from preferential shares into ordinary

3.2 Changes in financial structure based on foreign capital

In this case, these include changes: in maturity, in costs of debt, in guarantees and in origin of foreign capital. Decision resulting into structural change in foreign capital include:

- Decisions of the company on debt acquisition from several lenders rather than one
- Refinincing (because of more favorable interest rate,...)
- Decisions on loan repayment through another loan acquisition, (rolling debt)
- Decisions influencing guarantees and other security for loand acquired.

3.3 Changes in financial structure based on changes in ration between Debt and Equity (D/E)

These are financial decisions changing relationship between equity and foreign capital, but not the total amount of capital. Is:

1. The conversion of equity into debt

This can involve the situatuion when one of the shareholder withdraws his stake from the company, but until his stake is acquired by other shareholders, his stake shall be trated as a foreign capital.

2. Conversion of foreign capital into equity

The creditor who formaly provided the company with a loan decides to capitalise his debt associated receivables into equity and therefore becomes a regular stakeholder in the company.

3.4 Specific cases in funding a company

Include:

- finanacing a start-up
- raising additional capital
- reducing registered capital
- financing business disposal or takeover.

3.5 Financial Restructuring

Among the major financial decisions are business decisions on financial structure, which have a direct and important impact on the future prosperity of the company. Effective controlling seems to be one of the most important processes to influence decisions on financial structure and their possible change, with liquidity being always the most important variable in the process of achieving the optimal financial structure.

Reasons for the restructuring of the company itself are predominantely caused by negative effects of the external environment that influence and undermine the financial stability of the company and sustainability of its business.

4 ECONOMIC ANALYSIS AS A WAY TO ANALYZE THE CURRENT STATE OF STATE-OWNED ENTERPRISE

One of the main processes of overall economic analysis is assigned to financial analysis. As reported by Sedlacek, the financial analysis is seen as a method of financial evaluation of the company in which causal connection between the different data and trends of future development are revealed.[2]

4.1 Sources of information

Book-keeping if any economic system, whose primary goal is maximalisation of return on money spent, is an essential component in providing the basic economic information.

The basic inputs for the financial analysis are to be found in financial statements. Financial statements are therefore the main source of information for financial analysis of a company.
The financial statements include three basic financial statements:

1. Balance sheet
2. Profit and Loss Statement
3. Statement of company´s cash flows (cash flow).

1. Balance sheet

Balance sheet captures the assets and liabilities of the company, and is compiled minimally once a year (at the end of the business year). Balance sheet depicts the company in monetary terms and in two ways. On the one hand, as the sum of assets tehe company posseses (assets) are on the other as sum of sources used to cover these assets (equity and liabilities).

[1] Prof.Ing.Karol Vlachynský, CSc. a kolektív, Podnikové financie, Bratislava, 1994, 115 s, ISBN 80-225-0562-5, str. 75

[2] Sedláček, J.:Finanční analýza podniku. 1. vyd. Brno: Computer Press a.s. , 2007. s.3

Aktíva	Pasíva
Pohľadávky za upísané vlastné imanie Neobežný majetok – Dlhodobý nehmotný majetok (DNM) – Dlhodobý hmotný majetok (DHM) – Dlhodobý finančný majetok (DFM)	Vlastné imanie – Základné imanie[11] – Kapitálové fondy – Fondy zo zisku – Hospodársky výsledok minulých rokov – Hospodársky výsledok za účt. obdobie
Obežný majetok – Zásoby – Dlhodobé pohľadávky – Krátkodobé pohľadávky – Finančný majetok	Záväzky – Rezervy – Dlhodobé záväzky – Krátkodobé záväzky – Bankové úvery a výpomoci
Časové rozlíšenie	Časové rozlíšenie
Aktíva celkom	*Pasíva celkom*

Obr. 1 Balance sheet structure[3]

2. Profit and Loss Statement

Is a summary report of all incomes and expenses in the reported period. While compiling this report the practice to adding up all the income and deducting all costs i sused. At the end of the period the result of business period is reported where positive value stand for profit and negative for the loss.

3. Statement of cash flows – cash flow

CF statement reports cash incomes and outflows as they really happen throughout the period. While revenues ar recorded as on the date they were billed, cash income is recorded when company´s cash accounts have been credited for this revenues. On the expenditures side, outflow in CF statement is recorded everytime the cash accounts have been debited.

4.2 Methods of financial analysis

In financial analysis it is possible to use a variety of methods that contribute to a comprehensive analysis of the company. Sedlacek distinguishes two basic groups of methods.[4]

- Elementary methods of technical analysis
- Higher methods of financial analysis.

The first group uses basic arithmetic (elementary mathematics), the second group is based on complex mathematical procedures. Elementary methods are standard methods of analysis used by the company. Sedlacek ranks among elementary methods:[5]

- Analysis based on absolute indicators
- Analysis of differential indicators
- Cash flow analysis
- Analysis of ratios
- Analysis of indicators.

4.3 Indicators of financial analysis

The basic methodological tools of financial analysis are the relative financial indicators. The most commonly used financial indicators are:

1. indicators of profitability (return on investment),
2. indicators of activity
3. indicators of indebtedness
4. liquidity indicators
5. indicators of the market value of the company.
6. operational indicators
7. indicators based funds, and cash flow.[6]

5 EKONOMIC ANALYSIS OF F.G., Ltd.

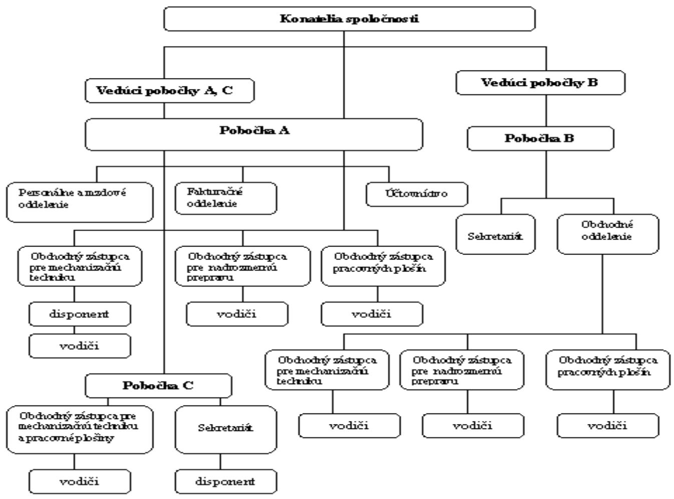
In this part of the paper ,financial analysis of a particular company, its economic, economic and business activities for the reference years 2009, 2010 and 2011, are presented.

5.1 Company Profile

Business name: F.G., Ltd.
Legal form: Limited Liability Company
Line of business:
- Technical inspection and testing of lifting equipment,
- Repair and service activities in the field of transport and mechanization,
- Earthworks and excavation with the use of heavy and special vehicles and tools,
- Support services related to the transportation of heavy and oversized loads
- Rental of machinery and equipment.

Capital: 66 430 EUR

5.2 Organizational Structure



Obr. 2 Organizational Structure

[3] KOTULIČ, R. a kol, Finančná analýza podniku. 1. Vyd. Bratislava: Iura Edition – Wolters Kluwer, 2007, 206s., ISBN 978-80-8078-117-0, S. 32

[4] SEDLÁČEK, J. *Účetní data v rukou manažera*, 2001, s.8

[5] SEDLÁČEK, J. *Účetní data v rukou manažera*, 2001, s.8

[6] ZALAI, K. Finančno-ekonomická analýza podniku. Bratislava: Sprint vrfa, 2000

5.3 The business activites of the company

FG Company, Inc., which operates in Slovakia since 2000, is a subsidiary of a foreign company. The portfolio of services offered is wide-spread. It is aimed to offer comprehensive services with regard to transport of oversized cargo and services in several areas of civil engineering. The company posesses special machanical tools and vehicles that are necessary and useful for a variety of businesses areas, where they increase flexibility and efficiency of work. The competitive advantage of the company is its large new and modern fleet of vehicles, specialized and professional approach of both company representatives and executive employees, but especially the uniqueness and specialness of service provided.

5.4 Revenues of F.G., Ltd

The main activity of FM, Ltd. is the provision of services connected to mechanization. Its offer is divided into 4 areas:

- Rental of car mechanization equipment with operator
- Rental of working platforms
- Transportation of Oversized and excess goods
- Handling works.

5.4.1 Services Share on company´s income

Revenues of Rental of car mechanization equipment with operator, the most demanded service in the years 2009 – 2011, accounted for 70% of the revenues in that particular period, the rental of working platforms accounted for the next 12% of revenues, followed by Transportation of oversized and excess goods with 10% and handling works with 8% of the revenues.

5.4.2 Occupancy vehicles and average price

Economic downturn had an impact on the demand and supply of services. During the period from 2009 to 2011 Company reported 15% drop in prices.

5.4.3 Payment morale of customers.

The economic crisis currently adversely affects the solvency of business partners, a fact, that must be taken into account and dealt with it appropriately.

5.5 Financial analysis of the company F.G., ltd.

The current financial condition and its development is captured in the financial statements.

The balance sheet, as mentioned above, shows the composition of the assets and liabilities - capital and its sources of coverage - of FG, Ltd. and convert them into funding for the reference years 2009, 2010 and 2011.

During analysis of income statement, revenue recorded 20% growth between 2010 and 2009. In 2011, the decline in revenues of 10% over 2010 has been recorded, while the lowest value of the cost has been achieved in 2009 and highest in 2010.

The highets profit has been therefore registered in 2010. In 2011, costs fell 17% compared to 2010, but revenues declined by 20%, what has overall negative impact on comapny´s profit.

6 DESING MEASURES TO IMPROVE IN A LOSS TO F.G., Ltd.

In this part, I will discuss proposals on how to improve the company´s performance by change in financial structure.

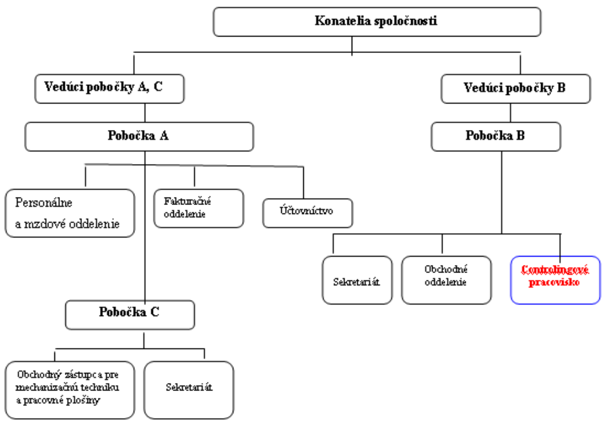
6.1 Organizational structure of F.G., Ltd.

Organizational structure within the company is relatively well distributed. Each branch is managed by branch manager alone. Important element in performance reporting and controlling is the accounting department, which monitors revenues and expenses of the company. Since the accounting department is centralized within branch A, the leaders of other branches have only limited knowledge of their actual performacne on affiliates level, as mostly global numbers are being discussed.

Proposal:

I therefore propose that there should be a controlling department established within the branch B and whose primarily responsibilities will be to closely monitor all costs and revenues of the bracnch, analyze them accordingly and suggest ongoing proposals and measures against negative impacts. This will cause the branch B to have have a fast and accurate information it needs to achieve better performance.

The following structure shows the proposed new organizational structure of the branch B with controlling department included.



Obr. 3 The newly proposed organizational structure of the company

Source: own processing

6.2 The bussines activites of the company F.G., Ltd.

Services offered by FG, Ltd. are diverse, complex, and therefore also challenging and costy. The Company's revenues are influenced by customers demand of the services offered, taking into account the competitors offers and their pricing.

Proposal:

1. Although the company is well known across the country as well as abroad, I would suggest to improve the *marketing.*

Pricing shall be changed to allow the marketing to communicate the prices as best price to service relationship on the market. While downturn I find it better to offer a service at the lowest possible prices (that means prices that do cover the basic costs of the service and allow minimum earnings) than not to take any action in terms of pricing and therefore loose customers and be at a loss.

Further, the website should be changed in order to introduce new service offerings to key customers as well as all other customer and present about the company´s offerings as suitable for consideration in various new business sectors.

2. *Collection of company receivables*

With the ongoing economic downturn, more and more companies are unable to pay for their liabilities. Such recivables are then given to court and are experiencing the legal collection. This always takes time, and the company must find adeqate way to cover for such a loss of cash until having collected receivables.

Proposal:

For new customers as well as for those, who do not cooperate with the company on regular basis and for whose there is no payment history, it is therefore advisable to initiate cooperation agreement on advance payment terms. For long-term contract, up to 60% down payment for the service in advance is advisable in order to avoid collection problems. For short-term contracts up to 35% down payment in an advance may be the solution.

6.3 Change of financial structure of F.G., Ltd.

Since 2009, the company financial structure has been changed as a result of several decisions made in property management, finance, investing and asset restructuring.

Despite its difficulty to find an optimal structure of assets in today's economy, it is very important. The greatest value of companies assets is attributable to immovable assets. In 2010 the company bought the immovable operational facilities in order to reduce their rental costs and other operating expenses.

The company has a wide fleet of mechanization technology. Most of this equipment is owned by the company itself, but a considerable number of mechanisms remains leased from the parent company. These leases cause the company to have a considerably high financial costs from leasing. Also, there is a significant value of chash held on the financial accounts without any reason. Investing or otjher active operations with this cash would definitely bring more profit for the company.

The structure of assets and liabilities for the reporting periods 2009, 2010 and 2011, allowing to analyse the evolution of individual positions is in the table below.

Assets				**Liabilities**			
	2009	**2010**	2011		2009	**2010**	2011
LTA	221360	**218160**	197004	**EQ.**	85590	**118430**	129030
				LTL	260000	**208500**	197074
CA	300000	**319100**	293530	**STL**	166928	**163630**	145230
Fin. Acc.	**263000**	**282000**	**253000**	**Curr. Liabil.**	**13500**	**60000**	**15000**

Tab. 2 Assets and liabilities of the Company

Source: own prosessing

Long term coverage

The Company´s equity is gradually increasing but still not sufficient to cover the fixed assets (DDA). Bank loans are very low, but liabilities from long-term leasing liabilities (DDZ) do, as already said, create potential debt burden of the Company.

Short-term liquidity

Throughout the monitoring period, the company has sufficient funds to cover short-term liabilities. The relatively high excess liquidity over the short-term commitments is then held as a reserve to cover the requirements of long-term leases, what is innapropriate.

If another agreement was reached between mother company and subsidiary as to hold cash reserve for the payment of long-term leases, it would free resources to be used on short-term financial market**.**

Proposals for action following the theoretical principles of optimising the financial structure.

In this part of my thesis, it is primarily discussed how the proposed changes in the structure of assets, equity and liabilities, would ensure more favorable conditions for the Company

1. Debt to Equity transition

Foreign capital is to a high extent presented by leased mechanization technology, and costs of which can be seen as financial cost resulting from the payment of such intragroup leasing

2011				+2012			
Assets	Assets	**Liabil.**	Liabil.	**Assets**	Assets	**Liabil.**	Liabil.
LTA	197004	**VI**	129030	**DDA**	392004	**VI**	324030
		DDZ pren.	**195000**			**DDZ**	65974
CA	293530	**KDZ**	145230	**OA**	253000	**KDZ**	159000
Fin. acc.	**253000**	**Cur. Acc.**	**15000**	**Fin. Acc.**	**205000**	**Curr. Liab.**	60000
	490534		490534		645004		645004

Tab. 3 Draft to transition of the assets and liabilities of the company

Source: own processing

Measures:

- 2012 constitues a base year for the draft of optimal measures to be taken by the company in order to achieve the optimal financial structure. Despite the year 2012 has been closed already, maesures proposed in 2012 may be well seen as measures proposed for the next years to come.
- The most principal proposal is the approval of the shareholders to invert long term leases into capital stake in the company.
- this would cause increase in physical assets by 195 000 and, of course, adequate increase its capital base, and therefore would mean increase in stability of the company, too.
- Although liquidity is reduced due to a moderate increase in current liabilities, but there is enough resources to cover them.

I recommend that the Company should follow the existing ratio between the value of current liabilities and the value of financial accounts and short-term receivables:

- ➢ *Change in machine ownership from parent company to Slovak subsidiary*
- ➢ *Reduction in rent for hiring the machines from a parent company*

2. Change of capital structure due to changes within own business field.

A. Following changes can be made in order to achieve better net profit for the company. From each profit there is 20% net profit deduction as a profit stake for the owner of the company. The rest of the profits will be as retained profit sused to self-finance the business.

- ➢ *Creation of profit reserves at rate of 20% from Net profits*
- ➢ *Use of available funds for short-term investment in the financial market.*

B. Raise capital through subsidies from the state budget or dotations from the public funds

This type of capital a company can achieve for establishing job positions for workers with reduced working capacity. For example, each branch could set up a position of warehouseman, anyway planned for creation, but in a way that would allow the compyany to increasing the capital contribution from the State or dotation form public funds.

3. Change of financial structure of foreign capital

A. Repair and maintenance of mechanisms, which is currently provided by certified foreign company is a substantial cost driver.

As the company currently has enough own qualified engineers who can provide routine repairs on the mechanisms, there is opportunity to train and certify these in house engineers for repairs of those mechanisms, and thus reduce these costs in longer term.

Development of costs for repair and maintenance services for years 2009,2010, 2011 (in thsd. EUR) are in the Table below:

Service repair and maintenance	**2009**	**2010**	**2011**
Mechanial equipment	60 000	89 000	75 000
Working platforms	33 000	42 000	31 000
Transport -trucks	12 000	19 000	14 000
Total	**105 000**	**150 000**	**120 000**

Tab. 4 State cost of providing service repair foregin company

Source: Own processing

B. Another option is to ensure the Slovak company that has the ability to implement these specialized repair mechanisms for lower costs.

I have requested and received a quotations from 3 Slovak companies A, B, C, which would provide repair and maintenance mechanisms. Their approximate calculations are given in the following table.

Service repair and maintenance	**2011**	**Firm A**	**Firm B**	**Firm C**
Mechanical equipment	75 000	72 000	73 000	69 500
Working platforms	31 000	28 000	30 500	28 000
Transport-trucks	14 000	13 500	15 000	13 500
Total	**120 000**	**113 500**	**118 500**	**111 000**

Tab. 5 The cost to repair service companies selected

Source: Own processing

The qutations could be further evaluated and after approval of final valuation matrix consisting of price, quality of service and references, selection of appropriate Slovak partner for provision of these repair finished.

C. Take a decision on the possibility of obtaining more favorable loan with lower interest rates and other terms to finance certain business matters.

6.4 Managment of the company

1.*Quest to reduce operating costs*

The cost based analysis shows that a substantial part of the company´s costs are operating costs that need to remain under controll. As I mentioned in the previous chapter, it is necessaryto reduce OPEXes linked to purchased machinery. Their reduction is a key in order to increase profitability and speed up company´s development.

2. Finding new ways to reduce extra costs

Extraordinary costs in this particular company are caused by reimbursement of damage to property caused by mechanisms and machines. They usually arise from improper handling, but happen also due to working activities performed in unforeseen circumstances.

These extra costs can be reduced through professional, responsible and flexible approach to employees who carry out this activity. In the case of failure, it is necessary that these extra costs are carried by the employees concerned or a insurance company.

3. *Find thoughts on increasing company´s revenues*

In the current state of economy, the diversity of services offered on the market is as important factor in deciding to use the apropriate services as are their costs. There is significant level of competition in Slovakia and therefore it is necessary to deal with the topics of favorable pricing not only from thecompany´s point of view, but rather from the customer´s one.

In this case, I suggest to adjust and apply new prices for service company´s service offerings in order to achieve higher sales volumes and provide services at affordable but still profitable level. Nevertheless, the executives must do a final decision here and i tis their taks to find a suitable pricing policy.

Anyways. the following table shows the possibility of new prices proposal for the services based on a calculation of operating and other expenses for a specific machine. As of my research these new prices are adequatw to the bids of competitors in Slovakia, would be seen as fair and would allow cost-effective conversion price, considering the quality and a wide range of service offered.

Overview of prices offered for servoces in 2011 draft and new prices for service offerings for 2012:

Machine	**2011**	**2012**
Machine A	40,00 eur	37,00 eur
Machine B	60,00 eur	55,00 eur
Machine C	70,00 eur	65,00 eur
Machine D	93,50 eur	85,00 eur
Machine E	112,5 eur	105,00 eur
Machine F	126,00 eur	115,00 eur
Machine G	140,00 eur	130,00 eur
Machine H	167,00 eur	158,00 eur
Machine I	180,00 eur	170,00 eur

Tab. 6 The proposal offers services mechanization technology

Source: own processing

7 CONCLUSION

The final aim of my thesis was to closely examine the relationship between of company´s financial structure (formed through financial decisions and cost structure changes) and profit of the Company.

I believe that this article will be effective contribution to the FG, Ltd. and will cause the company to start managing its financial structure and in this respect will add new options to continual change in the company on its quest towards prosperity and financial stability.