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THE ROLE OF THE FINANCIAL MANAGEMENT IN BUSINESS DEVELOPMENT IN LATVIA

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Abstract. In recent years the world economy has undergone major changes and the companies must be able to adapt to the new circumstances. The research shows that during so called “fat years” in Latvia many companies did not pay attention to the in-depth financial analysis and to the significance of it. But the economic conditions have forced to do so and currently more and more Latvian companies tend to focus on financial analysis and planning, as well as control. In Latvia the world experience in the field of financial management is learned approximately only in the last twenty years, and that is why this knowledge is not widespread.

Keywords: financial management, financial analysis, sustainable business, business development.

Jel classification: G39.

1. Introduction

The aim of the research is to analyze the role of the financial management and analysis in terms of sustainable business development in Latvia.

Financial management and being able to manage finances is very important, because without money and its successful management the company would be unable to survive, not to mention its development and growth. In today’s rapidly changing business environment, finance is more complex and challenging than ever before. Financial management theory and practice continues to grow at a high pace and the direct effects of this progress are changing economic conditions around the world. In Latvia the world experience in the field of financial management is learned approximately only in the last twenty years, and that is why this knowledge is not widespread.

Terms „finance” and „money” has different meanings, but in everyday life they have been mixed. As mentioned, both interpretations of the concept have significant differences, but there is plenty of things that make these terms pretty close. Finance appeared when the money had already begun to fulfill its specific function. Financial relationships were formed on the money relationship basis (Zalitis 2007).

Companies make decisions on a daily basis and, in principle, all business decisions are related to the financial consequences - gain or loss. Therefore the targeted use of financial management's principles and techniques has vital and strategic importance and can increase the value of the company, increase the efficiency, stability and profitability, as well as help to avoid financial losses and irrational costs.

The author believes that recently the role of financial management and analysis grow among companies in Latvia, more and more entrepreneurs analyze finances, identify and assess the risks that may arise in their business, so it is important to understand the meaning of the financial management and analysis.

This paper is based on existing literature, different researches, scientific publications and other materials. The research is mainly based on the monographic descriptive method and methods of analysis and synthesis, also the survey was conducted, where Latvian producer companies were surveyed about preparing the company budget, analysing and managing finances.

The research concludes that the significance of the financial management and analysis is expected to grow especially in terms of sustainable business development in Latvia.

2. The theoretical aspects of financial management and analysis

In 1960-ies the financial management took a special role for enterprises in the world. It was a practical need, which was based on the often failures of the financial experiences in the world. It was clear that business leaders must learn to connect company's financial analysis with risk analysis, capital structure and lending, corporate financial planning and control.

Doctor of Economics, the author of several books, lecturer, practitioner and workshop manager Saksonova (2006) indicates that financial management is a classical science, where revolutionary novelties almost are not possible. In Latvia, where the world's practice and experience in the financial management and analysis has been learned approximately only the last fifteen years, this knowledge is not widespread and used even less frequently.

Authors Baker and Powell (2009) define financial management as follows: Financial management is integrated decision-making process associated with the asset acquisition, financing and management, to achieve a common company's goal.

The main content and purpose of the financial management of any business is the control and surveillance of the cash flow (Rūrāne 2007). Lasher (2008) indicates that for managing the company the main goal or aim is needed, to which it is possible to measure the impact of decisions and performance. In economic studies, theorists (Rurane, Zalitis, Januška, Praude, and others) assume that the company's main goal is profit maximization. This assumption works in theory, but it is not controlled in real life.

The author fully agrees with Lasher's point of view that the decision to actually increase profits today (in short term) is likely to create serious problems for the company tomorrow (in long-term). For example, the Development department's work today brings the company a small investment because their work is focused on product development, which may be cannot be produced in the coming years. If the company dismisses employees of the Development department, today it will not affect production, but it will increase the profits directly to the account of cost savings. However, in one or two years, the company will not have any new products to manufacture and sell and it will come to financial problems. From this example conclusion can be made - simply increasing profits as today's goal is not the best long-term goal for real and functioning company (Laser 2008).

The founder of systematic economic analysis can be considered French scientist of the seventeenth-century J. Savary, who introduced the concepts of synthetic and analytical accounting. A major contribution to the economic development of the balance sheet analysis carried out I.Sher, P.Gerstner and F.Laitner, who introduced an analytical balance sheet distribution (Kasalis 2005).

The promotion of balance sheet concepts were activated by German scientists Guber, Broziuss and Schenvandton. Significant contribution to the above question in research and further development were given by Russian scientists Tatura (П. Татура) Andrianov (А. Андрианов), but later - Bakanov (Б. Баканов), Sheremet (А. Д.Шеремет), Dembinski (И. Дембинский) (Kasalis 2005).

Kasalis J. believes that financial analysis is the analysis of economic activities results - the process based on data research of the company's today's financial position and past performance to assess the conditions and results of operations in the future. The economic performance is represented with different ratios and indicators. Thus, the main task of the financial analysis is to reduce the uncertainty associated with the economic activity of enterprises, assess the financial position of the company and its future development prospects (Kelle 2011a).

The main purpose of financial analysis is to provide information for quality decisions and assessment of the financial situation. In practice financial statement analysis techniques have been developed, which are widely used around the world. Most popular methods are:

- horizontal analysis - a comparison with the previous period;
- vertical analysis - structural analysis of financial indicators;
- financial ratio calculation - determination of indicator correlation;
- trend analysis - determination of dynamic parameters change;
- comparative analysis - operating performance comparisons with the industry and competitors.

Zalitis (2007) underlines that financial accounting and analysis allows to evaluate and control the strengths and weaknesses, to identify opportunities and threats posed by the environment in which the financial relationships work. The author of this article believes, however, that the definition of the financial analysis should be broader or more specific, such as for example Polak's definition, namely, financial analysis and its main role is to provide users with an objective, neutral and independent information about the company's financial condition (Polak 2006).

Jeroshenko (2004) says that main goal of the financial analysis is to identify in a timely manner and eliminate deficiencies in the financial and economic activities, as well as to find ways to improve the financial situation. (Finanšu vadības rokasgrāmata 2004).

The author concludes that the principles and nature of financial analysis are studied by many authors and everyone gave more or less to its development and research. After studying numerous definitions from numerous authors, the author of the article gives her own financial management definition: financial management is a set of activities related to resources, assets and capital planning, fundraising, financing and investment to ensure a positive cash flow of their economic activity, and the implementation of some pre-set target, which is usually associated with a profit or owners' capital maximization.

3. The role of financial management in companies in Latvia

After the economic crisis hit Latvia, more and more entrepreneurs started to analyze company financial situation and, more and more business owner understand the importance of financial management and analysis as a successful company's future development.

Juris Binde, the member of the board of the Baltic Institute of Corporate Governance and President of the Latvian Mobile Telephone, points out that one of the main reasons why the situation is so bad for Latvian private companies, is that companies have strong desire to quickly get a lot of money and that is why many traders were unable to resist the temptation. He says: "Large loans were taken based solely on optimistic forecasts, provisions were not made and business was not diversified. This largely is a lack of experience and education." (Pelane 2011).

The company is a complex entity that exists in a given environment. Results of economic operations depend on the ability of company's managers to take into account environmental impacts, ability to predict future trends and make decisions.

This research paper shows the part of the survey results of 146 producer's companies in Latvia. The statistical data shows that there are more that 8000 producer companies in Latvia. The required number of respondents, which is 143, was calculated for the selection's extension to the general multitude.

As previously noted by author, after the economic crisis hit a lot of companies, the interest from business leaders, managers and owners is growing for growing about the financial management and analysis. On the research question "Does financial analysis and planning is carried out in your company?" convincing majority gave positive responses (Fig. 1).

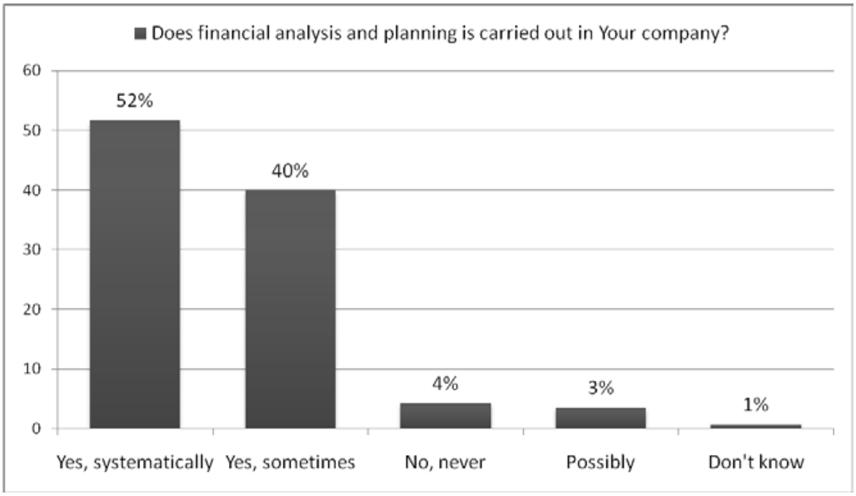

Fig. 1. Respondent answers to survey question about conducting financial analysis and planning in the company (Source: author's construction)

As Figure 1 shows, the majority or 52% of the respondents systematically carries out financial analysis and planning, and 40% do it sometimes. Only 8% of the surveyed companies never or perhaps carry out a financial analysis and planning. The author concludes that entrepreneurs' focus on financial analysis is welcome, and it will ensure the proper functioning and decision-making in the future.

Alexander Parfinovic, manager of the management consulting department in "Deloitte Latvia", already in 2008 is talking about the fact that in order to survive the economic downturn, Latvian companies must change. In this change the main role will have finance directors (CFO) as they must be able to decide where to invest scarce financial resources to work with profits. Finance Director shall also ensure company's ability to pay the creditors and also debtors' control, he should be able to agree on financing for growth or at least for staying at the same level (Parfinovičs 2008).

"In so called "fat years" part of business owners preferred to leave their businesses under the supervision of salaried managers, but the economic crisis made the owners to return in active business. Sometimes this kind of return is good for company, but sometimes it hosts just new problems, because decisions are not objective to the detriment of the evaluation of the real situation," points out Martins Kazaks (M. Kazāks) – AS Swedbank economist. Aiga Pelan (A. Pelane) from company BNS, indicates that the crisis in all its glory has highlighted Latvian private enterprise management style, which is often an important reason why businesses are affected by the survival,s problem (Pelane 2011).

Other survey question was about company's budget – does your company draw up the next year's budget? The figure 2 shows the respondent answers.

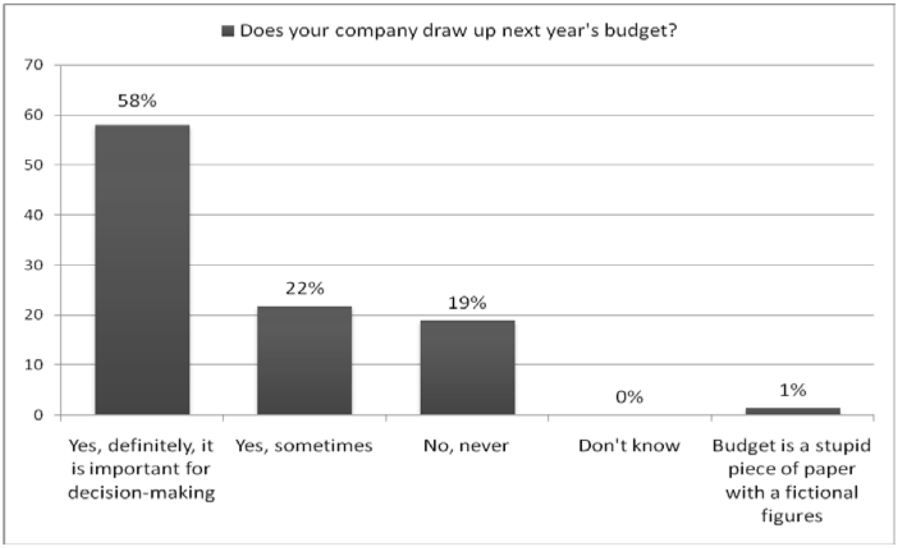

Fig. 2. Respondent answers to survey question about drawing up the budget in the company (Source: author's construction)

As figure 2 shows, 85 companies from 146 surveyed, draw up next year's budget, 22% do it sometimes, but 19 % or 28 companies never draw up a budget. From all surveyed companies just 1 company answered that budget is a piece of paper with fictional figures. Neste Latvija Ltd manager Armands Beizikis (A.Beiziķis) says that in 2007 Finance directors paid little attention to the risks of bad debts and credits, but now they are forced to find a solution in this area and gain knowledge (Parfinovičs 2008).

The author concludes that the financial analysis is an important element of the financial management. Almost all financial statements' users use financial analysis as a key element for making financial and investment decisions.

A little surprising for the author is the answer to the next question – does your company's revenue and expenses are planned in advance? (Fig. 3).

Respondent answers to survey question about planning revenues and expenses in advance is shown in Figure 3. If compare these answers to the previous question about drawing up the budget, one can figure out that 58% draws up budget, but just 49% plan the revenues and expenses. Figure 3 shows that 20 companies never plan revenues and expenses and 53 companies do it sometimes. Author thinks that 50% of surveyed companies shoud pay more attention to the budget and financial planning of the company as financial management, plannig and analysis gives great contribution to company's sustainable development and decision-making.

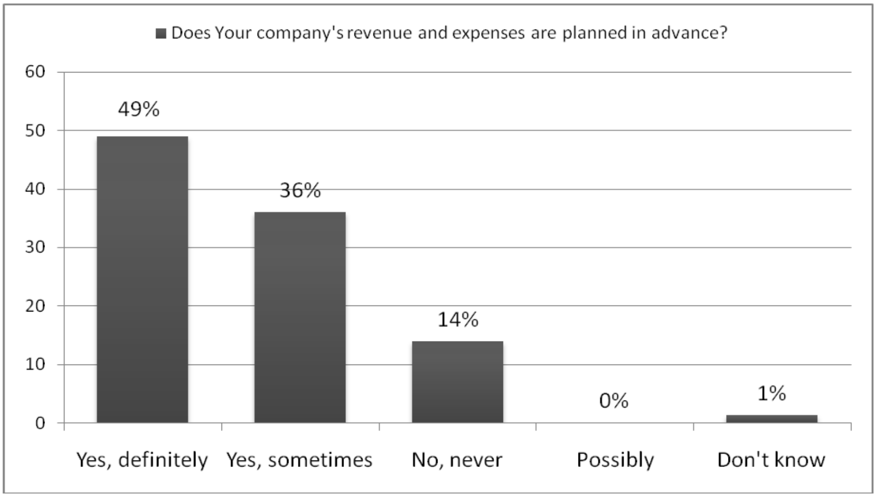

Fig. 3. Respondent answers to survey question about planning company's revenue and expenses in advance (Source: author's construction)

4. Conclusions

Decision-making is everyday process for a company and companies wishing to develop successfully need increased attention to cost reduction and efficient use of resources. For developing a sustainable business a very strong focus on financial management and financial analysis processes should be paid. The research gives main conclusions:

1. After literature analysis, the author has come to definition of financial management: Financial management is a set of activities related to resources, assets and capital planning, fundraising, financing and investment to ensure a positive cash flow of their economic activity, and the implementation of some pre-set target, which is usually associated with a profit or owners' capital maximization. Financial management plays an important role to every individual and company life cycle.
2. The financial management is a classical science, where revolutionary novelties almost are not possible. In Latvia, where the world's practice and experience in the financial management and analysis has been learned approximately only the last fifteen years, this knowledge is not widespread and used even less frequently.
3. The management style for Latvian private enterprises should change; more attention should be paid to financial planning and financial analysis.
4. The main aspects in Latvia for companies' sustainable development in the future will be cost reduction and effective use of resources.

The financial management, plannig and analysis gives great contribution to company's sustainable development and decision-making.

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