Mariana Rodica ŢÎRLEA
Christian University "Dimitrie Cantemir" Bucharest
Faculty of Economics - Cluj Napoca

ISSUES REGARDING THE FINANCIAL FLOW PROJECTIONS IN THE SELECTION OF INVESTMENT PROJECTS

Financial article

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Abstract

For a company, through investment activities, it is followed to either create new abilities or expand the existing abilities, the partial or complete replacement of existing technical base or its modernization. In the condition that it is desired the creation of a technical base, the investment involves the purchase of fixed capital that can materialize in: buildings, special buildings, land, vehicles, facilities, equipment, etc. In terms of expansion and modernization, investment implies the existence of a material base on which should be intervened wholly or partly by its development or modernization. For the selection of investment projects in the context of investment strategy established at enterprise level through a Financial justification and prioritization of investments this should lead to the achievement of the objectives set at its level.

1. Introduction

“Profit is the primary element that keeps moving any economic activity.

No economic entity will work if you do not make a profit, because it must obtain income to cover expenses incurred in the operation of the company's activity. Profit is a stimulus for the purposes of economic development of the business, but also financial source for business development. In general, owners or shareholders want the distribution of the whole net profit as dividends. Losses lead to reduced branches with problems in development and these lead to development of societies branches that lead to progress. Losses charge those entrepreneurs who fail to adapt their production of goods and services to consumers’ requirements. The quality of company management we can evaluate through the profit obtained by the economic entity (Nicoară, 2013)

For the enterprise, the goal is to obtain profit. As a result the investments represent a source of profit, a source of development and a source for supplementary income for businesses.

The specialty literature gives the investments the "investment function", motivated by the fact that investments are part of the enterprise functions. "These are mainly:

- The function to obtain contracts and orders from customers;
- production function;
- commercial function;
- staff function;
- investment function;
- Financial accounting functions (Badea, Dobrin,2006).

Investments are the result of financial management decisions aimed at obtaining new capabilities, development or upgrading an existing one, total or partial. An investment involves funding, respectively fixed capital. The effects of the economic efficiency of the investment are influenced by the achievement of fixed capital cost and the return on investment.

Theory and practice of specialty presents a classification of investment decisions depending on the conditions of risk. From this point of view the investments are grouped into investments with certainty, that have a high probability of realization because these are based on clear information, accurate and low influence of external factors and investment under uncertainty in which it is assumed that the investment will be able to take place, but with doubtful probability due to external factors influence growth, and not knowing their anticipated use of fuzzy information.

“Investment decision is considered as a multi-criteria approach, given the importance and its major role in financial theory.

All Investments for which can be done a simple prediction of financial flows involve consideration of their return and risk” (Badea, Dobrin,2006).

“Determining investments profitability should take into account the existence of a time lag of financial flows (Badea, Dobrin,2006).

“Profit maximization requires an effort on the part of the economic unit to analyze all factors influencing the activity of the company (production cost, volume and structure of production, the rotation speed of capital) and which to complete in profit maximization” (Nicoară, 2013).

2. Methods for forecasting financial flows that use the discounting technique

The literature presents two methods for forecasting financial flows METHOD NPV (net present value) and RIR- METHOD (internal rate of return).

These methods are "based on the time value of money, using the discounting technique. The goal is to bring from the future, in the present, values representing CFW, using the updating factors corresponding to a data rate of the average cost of capital of the company” (Trenca, pg.175).

a). METHOD NPV (net present value) to the extent that the net present value (NPV) is positive, projects shall be admitted as profitable.”(Trenca, pg.175)

The forecast financial flows in selecting investment projects

According to the legal framework, enterprise-wide "determination of cash flow, represents a synthesis of own resources, grouped by origin. In the case of investment projects, by determining the financial flows there is estimated the difference between the input financial flows and output financial flows.

The amount obtained as the difference between input financial flows and output financial flows represents the net value of the project.

“In other words, it is necessary the use of updating techniques. The benchmark indicator is the net present value (NPV). An investment is acceptable, according to this criterion only if the net present value is positive. This criterion corresponds, in the case of private companies, to increase the company value.” (Badea, Dobrin,2006)

b). “METHOD RIR- (internal rate of return method)

It is based on repeated attempts aiming at determining the specific project rates of profitability, corresponding to NPV = 0.

The advantage of these methods is the fact that:

- They follow the cash-flow throughout the project life
- .They permit to take into account the effects of inflation;
- They utilize and are based on conventional methods;

They, to a certain point can predict also external factors that could influence over time cash flows.

3. The importance of the cash flows scoreboard and their forecasting in case of investment projects

In the financial practice the dashboard of financial flows presents a major importance by the fact that it presents information regarding: the formation of the revolving fund, the improvement of the revolving fund, to varying needs for working capital, the revolving fund degradation , link with net cash and net cash variation issues.

For financial management, the dashboard financial flows represent a tool of information, analytic, control, in order to know the financial flows available as a result of operational activity financing and also the operational activity, the underlying investment decision making.

In case of projects, cash flow forecasting is performed over a period of time, respectively enrolling years coinciding with the life of the project. For the first year of life of the project, this amount for this year is allocated (distributed) also by months.

The scoreboard of forecast cash flows for projects presents vertically the next structure:

A. INVESTMENT ACTIVITY:
   a) Liquid inlets, which comprise: from asset sales of the company, capital contribution to the company, credit, project financing, medium and long term loans, grant aid;
   b) Total investment liquidity outflows for making payments for: purchases of tangible and intangible assets fixed assets including VAT;
   c) Total liquidity outflows in financing investment: loan repayments, interest payments and other financial payments.

B. CASH FLOW FROM INVESTING ACTIVITIES (FNV.):
   It is calculated the difference: FNinv. = [A] - [b] - [c]

C. OPERATING ACTIVITY:
   a). Treasury and cash equivalents at the beginning of period
   b). Receipts from customers;
   c). Payments to suppliers;
   d). Payments to employees
   e). Payments to the state budget
   f). Payments to the social insurance budget
   g). Interest paid
   h). Net cash from operating activities at the end of the period

D. CASH FLOW FROM OPERATING ACTIVITY (FNExpl.):
   It is calculated as difference: FNExpl. = [a]-[b]-[c]- [d]-[e]-[f]-[g]

E. CASH FLOW OF THE PERIOD (FNper.):
   a). Cash flow of the period: FNper. = B+C;
   b). Available cash derived from previous period;
   c). Available cash at end of period.

In order to achieve the dashboard of financial flows, it starts from the forecast of sales that will be generated by the investment project and the revenues expected from the basic activity of the company. The importance of sales is due to the fact that, on the one hand it forms the turnover and on the other hand, the results depend on the size of these sales. As a result, sales represent a very high risk factor, which is why their monitoring of the implementation of the first year of the project is broken down into months to follow its sales expected and to control the trend. The recommendation for sales forecasting is that they should be drawn up based on actual contracts concluded with customers. Related to such incomes the expenditure is forecast to be obtained such income respectively material costs, staff costs, costs the state budget and the social insurance budget. Based on these indicators will be established forecast the gross and net financial results of the company, i.e. the profit and loss account. At this level, it is possible to build also balance sheets the expected for the life years related project.

4. Conclusions

Financial management option for the decision of selection and implementation of an investment project involves the fulfillment of its efficiency criteria which result from the forecast indicators on the full length of his life:

- Correct prediction of the sales generated by the project;
- As correctly prediction of sales in operating activities taking account contracts in such a manner somewhat that the net present value to record only positive values on the full life of the project;
- Ratio of operating result to be higher or equal to 10%;;
- profitability rate on invested capital to be higher or equal to 5%;
- the leverage ratio on medium and long term to be no more than 60%;
- Correctly assessing of the need for capital;
- Correctly estimating of the revenue that the investment will generate;
- Correctly sizing expenses related to income;
- Internal rate of return (IRR) to higher than or equal to the average cost of capital.

For a project, there are realized several scenarios responding to the requirements of efficiency and selection after which it is analyzed and selected the scenario that achieves the highest profitability.

"Every entrepreneur should know that raising its economic strength depends on the amounts invested in business" (Bătrâncea, Stâneanu, 1997)

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