

## THE PREVENTION OF CRISIS AND THE COMPETITIVE EDGE AT SME'S

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### **ABSTRACT**

*SME's represent a very significant force in the Hungarian economy; it is important to be familiar with the state, development, strengths and weaknesses of the sector. The rating of the SME's has changed a lot recently. In 2004 and 2005 they increased the limits for determining the classification (annual net income, total assets). That is why lots of companies' situations have changed; formerly medium-sized enterprises now qualify as small businesses. Nowadays there is no single key to survival; several business factors must be considered. Companies must identify deteriorating conditions in time, accept the need for change, effect a quick response, provide continuous monitoring, and adopt a planning and controlling perspective. Domestic firms typically face liquidity problems; daily tasks and taxation issues cause a lot of trouble. They often feel that they are unable even to manage their own operations, let alone prepare a financial plan. The crisis has changed the style of leadership; usual labor relations have transformed. The acquisition of orders and reasonable cost reduction became an extensive "task," one that is no longer solely the boss's responsibility and interest. Because SME's have become quite heterogeneous, it is hard to define to whom the method presented in this study or this way of thinking should be recommended. In my opinion, the size of the investigated firms is not so important. The important thing is that those companies that rejected such a way of thinking should consider their activities and start using financial planning tools.*

Keywords: SME, financial planning, crisis, liquidity, effectiveness

### **INTRODUCTION**

The planning and the retrospection are inherent in everyday life, is present in our daily lives and in the economy. The planning is very important in the businesses and in the practice of the business operation. We elaborate plans based on information and strategic objectives, which sometimes look back to determine how satisfied. The SME's are very important area of the EU's economic priorities so of the Hungarian economy too, that's why very important to deal with this area by economic analysis.

The SME's have special problems but they dispose with specific break-out capabilities and strengths. Even on their economic characteristics is necessary the careful analysis by these enterprises, in my opinion they need for financial-economical help wherewith the SME sector in Hungary could develop.

### **THE IMPORTANCE OF THE SME'S**

If we compared the Hungarian economy to a pyramid then we can say that the SME's located at the bottom of the pyramid based on the number of enterprises

and their employees. They employing the most of the labours, they are the driving force for development; they give the significant proportion of the GDP.

The SME-s size is generally small relative to the market they have no control over the market,

they are not able to influence prices, so they are price-taking. Relatively they are only a few buyers in contact so the behavior of a customer is significant impact in their business operation. For example when a customer does not pay, this situation brings the enterprise to a dangerous situation and this means vulnerability (debt rounding). They largely depend on the political and economic regulators and their variations as well. Their flexibility is reflected in easier for could change their activities, the organization is smaller and the information can easier flow at the enterprise. They can make decisions more quickly, the entrepreneur both the owner and management usually, this option can be used in the above negative factors are offset. But this raises further problems, as the owner = family = management "formula" follows, that the entrepreneur" decisions based on their routine without economic calculations. They compared themselves tolerant, and let's be honest nobody likes to face his own limitations.

Their additional features: their activities are not too complex, have less capital reserve, so they are more sensitive to environmental disturbances (for example new standards, appearance environmental and health regulations, change of the tax system), they can less resources able to mobilize to their development. (Not to mention that medium-sized firms appear to be strong – in the domestic relations – due to smaller size constitute in the EU market like a small company.)

The SME-s can react with the increasing their competitiveness to the challenges of EU joining and the formed crisis. The most important possibilities: cost reduction, product/technology innovation, quality improvement, market research, competitions, vertical expansion of the activities (operation without subcontractors). By a company we could increase the efficiency in many areas, such as the fundamental processes, support and management processes.

Now, I would highlight the support processes; specify the planning method more specify the support of the financial planning.

It is important to clarify that the support should be permanent, not a casual activity is involved. So the competitiveness can prevail in longer-term which increase permanently the effectiveness of the company's compared to their competitors. We have to know the practicability of the financial planning is offended to everyone so we have to calculate this advantage can be to neutralize.

## **ABOUT THE FINANCIAL PLANNING**

The effective management of finances is now essential for all businesses. If we regulate the liquidity well and our investment and financing decisions are good the position of the SME's can be improved. Usually the investment strategy is highly incomplete at the large proportion of the SME's, the analysis of investment opportunities and the evaluation of alternatives are missed. The constant re-evaluation of the investment it is particularly problematic.

They usually decide to buy a machine or to the start of an investment that they do not draw up feasibility studies before, they do not expect payback time, they do not examine how much will be the first cost to provide a product or service.

Of course the financial part is not be separated from the investment strategy, the resources for the financing of the business activities it is must to determined. This is the self-finance and the finance with foreign capital. Both have a price, we have to thing over which version – possibly mixed – is the best. The financial plan is an important part of the business planning which emphasizes the focus to the effects of financial planning, to the forecast and timing the revenue and expenses.

At first step this plan uses the sales, production, investment, acquisition and budget data. This data based on historical data and on estimations. This includes the extraordinary events so the financial planning is a forward-looking process. It made not only because of forecasts but expressed decisions too.

“The aim of a financial plan is reflected of decisions at the financially effective operational and strategic horizon operation of the ownership of wealth.” (*Sinkovics*, 2002).

The condition for the efficient operation is efficiently working assets to finance, and the use of the resources give us eligible increment, the applicant resources will be proportional with the outputs. All of this we have to ensure with the lowest possible capital costs under reasonable risk. The financial plan is ensured the healthy assets and liabilities ratios, the liquidity, the efficiency and the profitability.

The functions of the financial planning:

- informing function: give information about the assets, income, financial position, about the aims;
- orienting function: shows a common direction of the activities;
- control function: compares the plan and actual figures.

Each firm resolves the financial planning differently. There is no single procedure but it can be problematic when someone who has other overwhelming tasks does this. One of today's practice they apply separate planner but this does not exempt the company management from the planning decisions.

The best practice when sets up separate expert group for the planning projects. Of shore this cannot be solved permanently at the SMEs, but a good solution is that if such a planning work than one project more experts from various professions work together. An applicable solution is when at start performs these tasks the company's accountant with the manager because they understanding of the business operation and the data receiving to them.

### **The financial planning process**

The financial planning it can be simplified realized the financial leader tries to give answers for the company's owners and managers of their peers' questions through the planning.

A successful planning process takes into account:

- the company's investment opportunities, the resulting long-term of assets deposit and theirs financial sources;
- the present financial and other economic decisions probable consequences of the company's situation and functioning;

- the possible decision alternatives through which we can select the company's actual financial decisions;
- followed by the actual decisions, to create known. "final financial plan"
- the final step follows delayed in time when we are comparing the realized economic and financial processes with the financial plans.

### **Liquidity planning**

The liquidity is an ability of a firm's that shows the company's possibilities to pay the mature commitment on a particular date.

The four basic-question of the liquidity:

- How quickly can we sell an assets? (monetized possibility)
- How to finance the assets? (cover of the assets, to in comparison the liabilities)
- What currencies are now available? (current assets)
- Is delivered a payment obligation of each period? (the in payment and the liquid assets exceeds the out payments?)

Cash in-flow plan is could be prepared from the sales plan, budget and cash out-flow plan is could be prepared from the production plan on the basis of sales. For this we can fit the other planed items (interest, taxes, investments and theirs financing) so we will get the periodical total cash flow.

Also includes to the liquidity planning that we might to make a plan for the resource gap if we involved additional resources and how to use or invest the unnecessary resource. Liquidity indicators are expendable too, which exam the proportion of the monetized asset and the current liabilities. (Cash finds, liquid securities and receivables.)

### **Profit and loss account forecast (Profit planning)**

As can be seen from the figure, on the focus of the effectiveness is the profitability and solvency. The levels of the calculation of income primarily give the amount of hedging and the profit of the ordinary activities because the manufacturing activity is in the forefront of planning decisively.

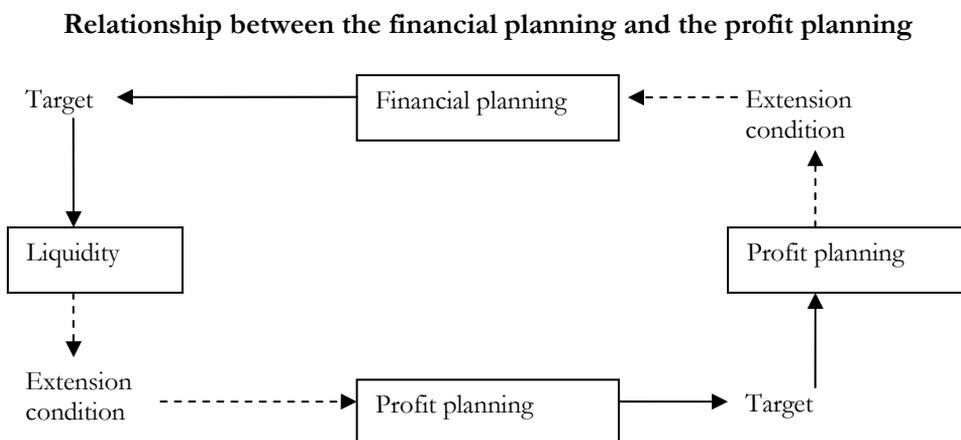
Through the profit planning is happened the quantifying of the profit-affectless incomes, expenses and costs, in different hedge steps usually.

Since the capital planning is a central issue of the planning so the liquidity and the profitability are in competition with each other. If we want to be too liquid than is not exploited our cash but if we have not any reserve than the liquidity get in jeopardy (*Figure 1*).

The closest interpretation we can start from the data of the sales and production plan when sales is determined the planned from market to market (average prices, volume) take into account their changes.

The part of the direct costs and indirect costs is definable if we known about the starter stock and sales plans. This is essentially similar to the income plan but also refers to the result next the profits as well. Particularly in commercial enterprises should not be forgotten the stocking activity either because the changes of the stock levels affects to the result. The increasing growth of capital acts with involve of stocks and deteriorating profit though the stock is "ours", so does not reduce the wealth.

Figure 1



Source: Szóka, 2007

### The forecast of the cash flow statement

The cash flow is all the money-flows of a company what is to say the difference between cash inflows and outflows during that period. The analysis of the profitability does not provide sufficient information to the assessment of the occurred changes in financial position. This claim is satisfied the cash flow statement and also the content is supplemented the data which are in the balance sheet and in the profit and loss statement.

It shows the company's operational and other funds will be devoted for which purposes. From the aspect that the cash flow forecast will be effective two important facts are critical. The first important factor is the cash flow statements will be compiled which time breakdown (monthly, quarterly), the second important factor is this statements how often made.<sup>1</sup>

The task of the cash management is defining and providing the minimum level of liquid assets which ensure the normal course of business. This indicates a relatively low level of cash.

This is quite a difficult task in practice if the liquidity sinks to low level then the management could be jeopardized. The liquidity can be achieved if we dispose exact information about the stocks, the production and about the expected demand.

We can further reduce the required stocks level if we organizing more efficient the production with lower stock levels and with suppliers – if may – “Just in Time” contracts will be concluded.

### Break-even point analysis

Due the analysis we should to know as the product, investment or as a whole company when we become profitable. The break-even point is that volume of sales

<sup>1</sup> “The problem with the balance sheet and profit planning is that the realization measurement of this plans complete closure is needed monthly or quarterly” (Sinkovics, 2002. 59. p.).

revenue or amount of the break-even point which covered the ongoing not be distributed costs. Then not will generate nor operating profit or operating loss for the company. It shows when we reach the level of revenue that will be needed to cover for all variable and fixed costs, when the total revenue and total costs are equal.

This instrument can be recommended for SMEs, for any reason because relatively easy to determine how many units have to be sold and what time would we get zero results.

(In the case when we product only one unit and when the unit selling price is higher than a variable cost per product and may be covered by the fixed costs for the surpluses then we get the break-even point.)

## DISCUSSION

### **SME's financial planning system**

A good planning system for SMEs:

- increase the transparency, timeliness and usefulness of the information,
- focusing the attention of the company's management to the profitable/loss products, processes,
- encourage the communication,
- makes visual and transparent of the current state,
- taking into account the cost-benefit approach, the practicability,
- with non-financial indicators will complement the company image, and
- operational and strategic aspect can prevail in it.

The tasks is defined and organized in the plan, the plan coordinates the subtasks and optimizes the use of resources, so this will help respond to changes in the environment. The conscious Corporate Governance is grounded by a specific expectations worded in an efficient way in management. In general, the planning is started with traffic planning, sales market test by the professional literature. We plan from market to market and from product to product the quantity sold and theirs price.

The capacity (personal and technical) and the stock level changes (uncompleted, semi-finished and finished) can be adapted to the traffic volume plan. It has shown the need for working capital and labor costs. The deficit or surplus entails with consequences in the areas of human resources and investments. (To recruitment or sent? Invest? From what?)

This production plan defines the costs and the secondary passes and general costs still be considered.

Thus we get the result plan which is issued about the operating profit. This will be continued in the basis of profitability and balance sheet until the final profit. The impact of financial planning assessments the financial plan, namely the financial plan which in terms of liquidity, is examined the coherence of the total revenue and total expenses (*Horvath and Partner, 2001*).

The basic requirement of the sales activity is the appropriate volume, self-cost, consistence and price levels of sales. His job is to the company's sell in the future, the policy instruments to achieve the applicable sales and the implementation of

sales devoted to cost to determine in a specified period. The sales plan is based, generally, all other functional operating plan eventually this ends through the production and purchasing plan to a financial and results plan.

So the sales are a target-oriented economic task which is included the sales policy development and decisions. Optimal performance of these tasks in the firms are several tools, methods are available.

If these procedures (eg, market research and sales methods, pricing policies, product construction, advertising, etc.) not just in some cases but systematically are used built on one another, then we are talking about marketing.

However this simple financial plan cannot be found at the significant proportion of the SME-s therefore it is necessary to teach and accepted such of skills. After the collecting of the base data, in light of trends and changes plan variants have to be developed for the revenues and expenses, which is determined for us the company's financial plan presented in the above course of action.

It should be monitored that not only the revenues and expenses are of the background of controlling the financial calculations but the liquidity and its forecast namely, that the in and out payments how are they face each other on-time (Reke, 2007).

We must plan for the cash sales and credit sales separate, for the credit sales we could used the customer tables (by age) which indicate the claims "age". (The older our unrecovered claims the more probable that is not expected to influence.) The planned and the actual data of sales is planned formalized too, we represent graphically and cumulatively the monthly data.

So it can be seen plasticity and easy to understand plan and compliance data in front of us. We need to look a month, but at least quarterly the discrepancy between the plan and the actual data too. They show us what is due to deviation from the plan.

The most common examples:

- the falling away of the existing customer group and the old customers;
- changes in market share, the increasing / weakening role of the competitors;
- trends of the whole market sales;
- an unexpected stock trend;
- introduction of new products, new market break;
- inflation and other economic factors;
- pricing policy (if the prices do not accept, but formed).

Modifying effect of these price and volume should be taken into account during the planning; the base data with these effects should be modified. Examine the causes of deviations because it shows us the next step towards abolition of the derogation. In my opinion for the SMEs' s the best planning method is the rolling planning because of the frequently updates results in higher accuracy.

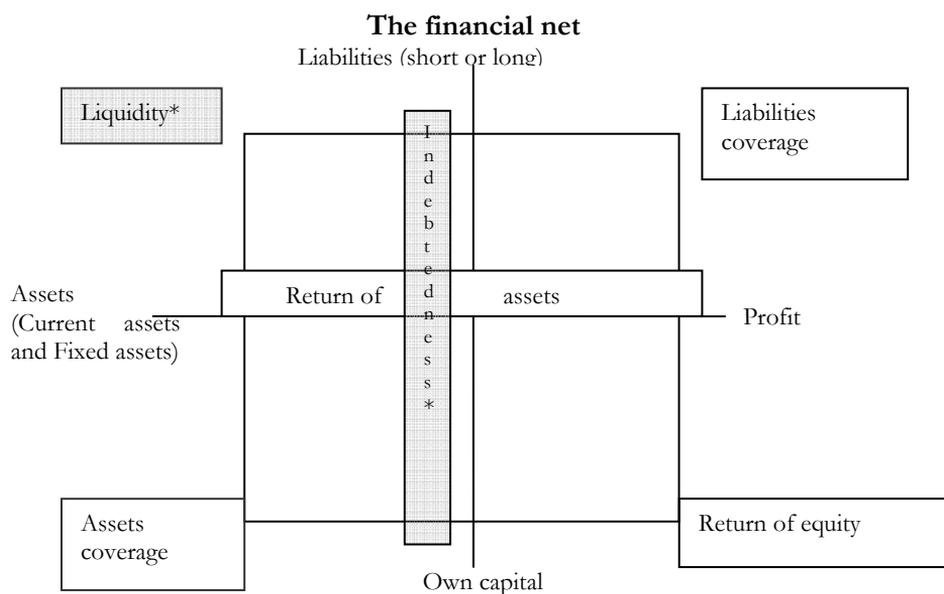
The profit plan is needed to compiled based on the past three years data – and based on the expected significant changes – the data is needed expand to quarterly level and then using the technique of rolling planning push forward with a quarter of the plan horizon expect of the known / expected changes. Of course, these data should be checked namely, we should be analyzed the plan/fact gap sometimes.

## FINANCIAL NET IN THE SYSTEM OF FACTOR ANALYSIS<sup>2</sup>

My financial net shows in graphical form the connections of indicators and aims which used in the financial planning. It is shown that in the vertical axis the Commitments, and the Capital is in located, while in the horizontal axis are the Assets of the Result.

When we square this financial nets and look at the quarters lines it is shown overall, constitute an own net/system the compliance of liabilities, the return on equity, the assets coverage, the liquidity, the profitability and the instruments debt levels indicators (*Figure 2*).

**Figure 2**



*\*The financial short-term indicators are shown in gray so it should be more often.*

Source: *Szóka, 2007 based on Witt and Witt, 1994*

The net financial shown above, although in fact in compliance with the scientifically based selection of indicators / organizational but our requirements point of view not sufficient because the often examined indicators belong to the SME's financial planning system. So this financial net must be adapted to include these items and indicators.

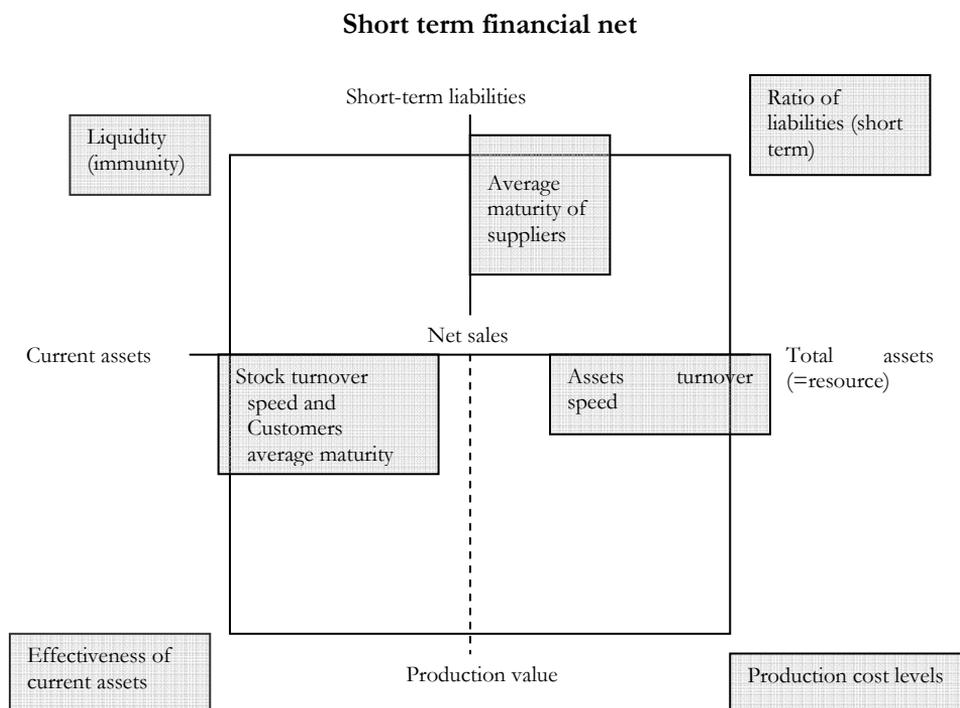
The advantages of this net the visual form which helps to understanding the connection between comparison plan and actual figures and the main aims.

The short-term indicators are shown in gray so it should be examined weekly or monthly during the years of operation. We can see there a dotted line, so this is a little bit compromise, that the liquidity, the stocks, customers, suppliers (both in the

<sup>2</sup> See in my doctoral thesis: *Szóka, 2007. 153-159. p.*

short time) rotation speed/average duration – we investigate in one system. Independently it is established the short term, more often calculated indicator logical system in *Figure 3*.

**Figure 3**



Source: *Szőka, 2007*

Of course the indicators aren't magic tools. These indicators help us to ask (good questions) but don't give us answers. In this paper I deal now with the short term financial planning whereas in times of crisis it is more important. For the indicators for all companies of course, there are no valid criteria, these emphasizes the changes and we have to answer for the changes.

The financial planning monitoring is difficult to past in the daily work, but it can be done once in a month.

The essence is the rapidity; we have to know how much the time-limit of a measure is. (Intervention-time, effect-time, result-time) Instead of planning we should to tried forecast continuously this indicators and this indicators is should to reviewed weekly using help the accounting.

### CONCLUSION

According to the Hungarian Central Statistics Office about 10% going bust of the newly established Hungarian enterprises and approximately 38-40% of them are not

survive the 6 years. So we can see that especially now, during the crisis the intervener quick action is needed for every business with the right tools. The domestic firms struggle with liquidity problems typically, suffered from the daily tasks, and taxation.

It is a wide-spread opinion that in the SME sector there is not enough attention paid to financial planning. However nowadays we are not in the ages when an entrepreneur can act his own mind and head, therefore there is/would a need to present the functioning based on financial point of view.

In this publication I have tried to present for SME's an easy to use, simple, but also newness-including financial system, which could be efficient, because it is complex, but sufficiently simple and introducible, so it will not scare the entrepreneur who are just companying with planning and controlling.

The system is adaptive, so conformist, the structure and with the change of used indicators is able to satisfy the varying demand. The system can said stable, it is working in equilibrium, because the applied controlling methods and the indicators made with scientific base are making an integrated system, not expressions of a capricious willingness.

Usage of this system is justified, because we know the fact, that there are very much unsuccessful working enterprises in Hungary. The toolbar of financial planning and controlling, and the information flow become real driving force through human interaction, however in the case of SME's it is not so easy to form the organizational and communication system of it. Training, forming point of view has a big importance, for this job-enrichment is a good accessory, but no bad, when a real controlling-minded executive or expert also works – even in part-time work - in the article.

No need to be perfect, get the best, and improve sometimes, because building the controlling mechanism not a one fold event, it is an ongoing developing process. Because of strategy, environment, management, controlling system can change this dynamism for SME's will always exist. This dynamic work should build in to the workers and managers thinking method. The goal is everybody understands and accepts the importance of this. Simplicity is important also in reports as well in the usage of understandable managing accessories. We should understand that these methods are not against the organizational processes, rather the “coaches”.

At present times the most important key for survival is not based on only one factor, rather the existence of more corporate factors which are the recognition of worse going conditions on time, acceptance of the need for change, quick reaction – even at the questions of organizational changes – and the adaptation of continuous monitoring, planning, controlling approach.

The Hungarian enterprises typically fighting against liquidity problems, milling in the daily tasks. They often feel, that it's unable to control even their operation, so not to make financial plan. Crisis had changed also the management style, the used work relationships have formed, organizing the orders, the rational cost reduction became also important task for SMEs as well, so it is not anymore the task of the executive.

We shouldn't walk beside this opportunity – which can be also competition advantage – and strongly recommended to use this system. The invested time and few capitals will gratitude, and so our financial processes will become manageable.

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