Optimizing Cash Flow

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Abstract

In a globalized world economy, it is increasingly difficult for an economic entity to meet its financing needs unless it has a substantial financial baggage. It must therefore secure this financial baggage either from internal or external sources. It should be taken into account when these sources are used because in both situations various costs are involved which may not be accessible to any economic entity, especially since sometimes the very activity of the economic entity involves high costs that must be covered. In the scientific approach we have presented a number of ways to optimize cash flow and we have presented in more detail two of them, each with advantages and disadvantages, factoring and outsourcing. There may be other ways in addition to what I have presented as ways of optimization.

Key words: cash flow, expenses, factoring, receivables, outsourcing
J.E.L. classification: D24, G32, M41

1. Introduction

Cash flow provides information about the money actually flowing into and out of a business over a given period of time. It effectively reveals a company's ability to generate cash and manage its current payments.

Cash flow is of three types, namely:
- Operational (from operating activities) - generated from the company's core activities;
- Investment - cash used or generated from the purchase and sale of long-term assets:
- Financing - cash obtained or utilized through external sources of financing.

Optimizing cash flow is essential to maintaining the financial health of a business and is achieved through several methods.

The main objective of this scientific approach is to identify the main methods of cash flow optimization.

The question may arise why is it imperative to optimize cash flow? The cash flow of an economic entity is very important because it underpins the activity of this entity, providing the necessary liquidity to carry out the activity. Liquidity is needed both to honor contracts for the purchase of goods, commodities, raw materials, etc., and for various payments within the entity such as salaries, rents for premises, utilities, etc. At the same time, taxes and duties owed to the state must also be paid.

2. Theoretical background

Effective cash flow management is an imperative for economic entities seeking to secure their financial needs. As a result, the identification and implementation of optimized cash flow strategies are essential to sustain business activity and minimize associated costs. The present study explores two main methods of cash flow optimization: factoring and outsourcing, each with specific advantages and disadvantages.

Factoring, a financing method whereby a company sells its uncollected invoices to a factor in exchange for an immediate advance of capital, is an efficient option for companies that require quick cash to support their current operations. Although factoring may incur additional costs, such as fees and interest, these can be justified by the quick access to capital and improved cash flow (Herciu *et al*, 2023, p.308).

On the other hand, outsourcing, the process of delegating non-core activities to third parties to focus on core competencies, can provide significant cost savings and improve operational efficiency. However, much depends on selecting the right suppliers and managing contractual relationships effectively (Abu Elnasr, Etman and Sanad, 2022, p.133).

These strategies, although effective, are not universal and require careful consideration of the specific context and needs of each economic entity (Brasoveanu, 2023a, p.56; 2023b, p.46). For example, Aivaz and Avram (2021, p.475) emphasize the importance of assessing the financial performance of companies before choosing a cash flow optimization strategy, arguing that the economic and sectoral context can significantly influence the effectiveness of these methods.

It is also important to consider the impact of these strategies on the business model and long-term sustainability. Matei and Aivaz (2023, p.978) explore how asset compliance in financial reporting can influence cash flow optimization decisions, highlighting the need for increased transparency and rigor in financial valuation.

Cash flow optimization is thus a necessity adapted to complex global market conditions. Factoring and outsourcing, as optimization strategies, need to be assessed according to the specifics and needs of each company, considering the internal and external factors that may influence their effectiveness. Successful implementation of these strategies requires a deep understanding of financial mechanisms and continuous adaptation to economic dynamics (Munteanu *et al*, 2023, p.203).

Continuing the discussion on optimizing cash flow across sectors, it is essential to understand the impact of regulatory compliance and non-compliance on companies' financial performance. Research in recent years (Chiriac, Munteanu and Aivaz, 2022, p.298; Aivaz *et al*, 2022, p.4) explores the financial implications of noncompliance in transportation businesses, highlighting how noncompliance can generate significant costs that negatively affect cash flow. These costs can range from fines and penalties to lost revenue due to business interruption.

In addition to compliance issues, investments in sectors such as agriculture, forestry and fisheries play a crucial role in optimizing cash flows across economic agents. Agu *et al* (2024, p.37) examines the dynamics of the level of investment in these sectors, highlighting how strategic investments can contribute to coastal development and improve overall economic performance.

In the context of the COVID-19 pandemic, the HoReCa sector has been severely affected, and Aivaz and Capatana's (2021, p.289) analysis of the asset returns of companies in this sector in Constanța County provides valuable insights on post-shock recovery. They highlight the importance of effective asset management to maximize profitability and stabilize cash flows in times of uncertainty.

Moreover, Aivaz (2021, p.31) investigates the impact of subsidy revenues on turnover for agriculture, forestry and fisheries companies in the Black Sea coastal zone, highlighting the role of subsidies in supporting liquidity and financial optimization of these entities. It emphasizes how critical these external revenue streams are for financial sustainability in capital-intensive sectors.

Similarly, Aivaz *et al* (2019, p.115) discuss the commercial profitability of companies in the coastal localities of Tulcea County, emphasizing the importance of asset management and the correlations between assets and turnover. These correlations are essential for strategic financial planning and continuous cash flow optimization in specific geographical regions.

Therefore, the application of financial optimization methods needs to be tailored to regional and sector specificities, recognizing the variability of market conditions and the need for a flexible and informed approach to cash flow management.

In today's economy there is an increasing emphasis on the need for liquidity even though most transactions are done through banking instruments. Payments to suppliers of products and/or services have to be made, but in order to do so, an economic entity needs to be liquid.

The issue of cash flow arises all the time because there are situations when, in theory, an economic entity has cash, but in practice it is tied up in assets or in receivables. And it is precisely here that it is imperative that the entity's management "works" to ensure that the cash flow is certain and liquid.

An example is shown in Table 1.

Table no. 1. Cash flows situation

Item name	Financial year	
	N	N+1
Cash flows from operating activities:		
Receipts from customers	286.054,00	188.536,00
Payments to suppliers and employees	240.544,00	150.120,00
Interest paid	0,00	0,00
Income tax paid	92.998,00	6.450,00
Receipts from earthquake insurance	0,00	0,00
Net cash from operating activities	*-47.488,00*	*31.966,00*
Cash flows from investing activities:		
Share purchase payments	0,00	0,00
Payments for the acquisition of tangible fixed assets	69.690,00	0,00
Proceeds from the sale of tangible real estate	0,00	0,00
Interest collected	27.029,00	9.396,00
Embedded dividends	0,00	0,00
Net cash from investing activities	*-42.661,00*	*9.396,00*
Cash flows from financing activities:		
Proceeds from the issue of shares	0,00	0,00
Loan receipts	2.500,00	3.000,00
Loan repayments	2.500,00	3.000,00
Dividends paid	102.560,00	349.180,00
Net cash from financing activities	*-102.560,00*	*-349.180,00*
Net increase in cash and cash equivalents	**-192.709,00**	**-307.818,00**
Cash and cash equivalents at the beginning of the financial year	**600.562,00**	**407.853,00**
Cash and cash equivalents at the end of the financial year	**407.853,00**	**100.035,00**

Source: Author's processing

It is easy to see that the three types of cash flows play an important role in determining the cash and cash equivalent position at the end of a financial year.

3. Research methodology

In this research, we delve into the intricate processes of optimizing cash flow within economic entities, recognizing its important role in sustaining financial health and ensuring operational continuity. The primary focus of our study is to explore and articulate the various strategies that businesses employ to manage their cash flows effectively, with an emphasis on how these strategies impact their overall financial stability and efficiency.

The methodology of this research is anchored in a qualitative approach, combining an extensive literature review with a detailed analysis of case studies. Through the literature review, we engage with a broad spectrum of existing academic and industry insights on cash flow management techniques. This comprehensive examination highlights the nuanced benefits and challenges associated with prominent strategies like factoring and outsourcing.

Factoring emerges as a strategy where businesses sell their outstanding invoices to a third party at a discount to gain immediate liquidity. This method proves especially beneficial for entities requiring quick access to cash to maintain their operational flow. However, the associated costs, such as fees and interest rates, demand careful consideration against the immediate financial relief it provides.

Outsourcing, on the other hand, involves delegating non-core functions to external experts, allowing businesses to concentrate their efforts and resources on their primary activities. This strategy can lead to substantial cost savings and operational efficiencies. The effectiveness of outsourcing, however, hinges on the ability of the company to select the right partners and manage these relationships effectively, ensuring that the outsourced services align with the company's strategic goals and quality standards.

The data collection for this study involves a thorough review of scholarly articles, industry reports, and case histories that detail the implementation and results of different cash flow management strategies. This eclectic data gathering enables us to identify prevailing trends and draw significant correlations between the success of specific strategies and the conditions under which they are employed.

Through careful analysis, we synthesize the gathered data to uncover the circumstances that favor cash flow strategies over others (Rus, 2022, p.1012). We look at variables such as the size of the company, the industry in which it operates, and prevailing market conditions to determine the effectiveness of each strategy.

The insights gained from this study are intended to deepen the understanding of cash flow management, providing valuable guidance to business leaders and financial managers. By elucidating the advantages and limitations of various cash flow optimization strategies, this research aids in making informed decisions that bolster a company’s liquidity, ensuring its capability to fulfill immediate financial obligations and to plan strategically for future growth.

In essence, our research methodology not only captures the complexity of financial management in contemporary business environments but also contributes meaningfully to the discourse on sustainable economic practices. Through this detailed exploration of cash flow optimization techniques, we offer a nuanced perspective on financial management that is critical for any business navigating the challenges of today's economic landscape.

4. Findings. Ways to optimize cash flow

Improving debt collection - this involves reducing payment terms, which involves negotiating shorter payment terms with customers, prompt invoicing, i.e. sending invoices immediately after delivery of goods or services, tracking overdue payments, i.e. it involves an automated system of notifications for late payments, as well as offering incentives, giving discounts for early payments.

Managing payments to suppliers - involves negotiating payment terms, extending payment terms without affecting supplier relationships, payment in installments (installments), especially where this is possible, and strengthening relationships with suppliers, to obtain more favorable terms of payment and delivery of products or services.

Inventory optimization - involves avoiding overstocking, by monitoring stock levels to avoid cash being tied up in stocks, implementing sourcing strategies to reduce stock holding times and continuous analysis of demand by using forecasting in procurement planning.

Expense control - consists in reducing fixed and variable costs, which can be achieved by identifying expenses that can be eliminated or reduced, automating processes by making investments that reduce operating costs, and outsourcing, i.e. outsourcing activities that are not essential to the business of an economic entity.

Revenue maximization - is based on diversifying revenue sources by introducing new products or services to attract new and more customers, increasing prices by moderately adjusting prices where possible, and a customer retention strategy that requires building long-term relationships to ensure recurring revenues.

Planning and forecasting - analyzing cash flow, requires monthly projections to anticipate cash needs, the establishment of an emergency fund, i.e. reserves for unforeseeable situations, and the use of software tools, i.e. financial management applications to monitor the business entity's activity as closely as possible.

Accessing sources of finance - consists in accessing lines of credit, accessing lines of credit to cover liquidity needs in periods of deficit, factoring, by selling receivables to obtain liquidity, or calling on investors, both internal (shareholders, associates) and external, when a capital infusion is needed.

In what follows, I will present two lesser-known sources of financing: factoring and outsourcing.

Factoring is a financial process whereby a company sells its trade receivables, in this case invoices receivable, to another entity called a factor in exchange for immediate cash. This is a way for companies to get quick cash without waiting for customers to pay.

The document cycle is as follows: the business entity issues an invoice to the customer for goods or services delivered, the invoice is sold to a factoring company, the factoring company pays a portion of the invoice amount, ranging from 70% to 90% of the invoice amount, and after the customer pays the invoice to the factoring company, the factoring company transfers the balance of the invoice amount to the business entity, less a factoring fee contractually agreed upon**.**

Factoring has both advantages and disadvantages. Advantages include an improvement in cash flow, so that economic entities can access liquidity immediately, the risk of default decreases because in non-recourse factoring the risk is the factoring company's, and at the same time, it greatly simplifies the management of receivables. The disadvantages include high costs, since factoring fees are not low and are often a percentage of the value of the receivables to be recovered, economic entities may become dependent on such a mechanism for obtaining liquidity and, last but not least, the repeated use of factoring companies may lead to a deterioration over time in relations with some customers.

Factoring is a useful solution especially for small and medium-sized companies that need quick access to capital and work with long payment terms.

Outsourcing is the process by which a company outsources certain activities, processes or services to another specialized firm instead of performing them in-house. The main purpose of outsourcing is to reduce costs, increase efficiency or access specialized expertise.

Like factoring, outsourcing has advantages and disadvantages. Advantages include cost reduction, i.e. companies can save money by avoiding investments in equipment, infrastructure or staff training; access to expertise, i.e. access to professionals with experience or advanced technology; focus on core activities, i.e. freeing up internal resources to concentrate on core competencies; operational flexibility, which allows scaling resources according to needs; and a reduction in time to market, which means that outsourcing to specialists can speed up the processes of launching products on a new market (Adjei et al., 2019, p.38; Abdel-Raheem, 2013, p.245).

Examples of activities that are usually outsourced are IT services, human resources (recruitment, payroll administration), support services (call center or customer service), production of components or marketing for advertising campaigns.

5. Conclusions

Cash flow optimization is an ongoing process that requires regular monitoring and proactive adjustments. Implementing these strategies can ensure financial stability and sustainable business growth.

An economic entity always needs cash to conduct its business, regardless of the area of activity. If this is not available internally, then the entity has to turn to external sources of liquidity, which seems natural at some point in time, especially when it wants to expand the market in which to operate.

At the same time, however, the use of external sources also comes with some risks that may arise, such as market risks, operational risks, etc., which is why liquidity indicators must be closely monitored to avoid undesirable situations where the entity may end up heading towards bankruptcy.

It is desirable to draw on internal sources to meet cash flow needs and to make investments when the entity is found to have a cash surplus.

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