Impact of Turnover on Cash Flow

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Abstract

Cash flow is very important in the activity of an economic entity, as the very existence of that entity depends on it. The greater the amount of cash flow available to the entity's management, the more it can be used to expand the business or at least to maintain the entity's operations. An increase in turnover is one way of increasing cash flow and has a large influence on its value. But it should not be forgotten that uncontrolled turnover growth without proper management can generate financial pressures. In the scientific approach I have tried to show how turnover can influence cash flow, I have presented the financial risk that can influence turnover and I have determined that good financial planning can lead to an increase in turnover.

Key words: cash flow, turnover, financial risk, financial planning, budget, financial risk
J.E.L. classification: D24, G32, M41

1. Introduction

In the activity of an economic entity there may be problems with cash flow, which decreases for various reasons (collection of receivables at longer periods of time, price increases for products and/or services, etc.), but this may also be due to a decrease in turnover.

The decline in turnover has many causes, including inflation, decreasing purchasing power, increased competition, economic and political uncertainty, etc. Therefore, economic entities need to be prudent in their future estimates for sales, cost and profit budgeting and take into account more pessimistic estimates and scenarios (lower sales, delayed receipts, etc.) and estimate the impact of these variables on profit and cash flow.

The objective of this scientific endeavor is to trace how turnover can influence cash flow and also the financial risk to which an economic entity is subject when a decrease in cash flow occurs, which can have consequences that can lead to the insolvency of the economic entity.

2. Theoretical background

Cash flow is a vital component in the activity of any economic entity and is fundamental to its survival and development. According to this study, turnover growth appears to be an effective means of boosting cash flow, significantly influencing its value. However, it is essential to realize that uncontrolled turnover growth without proper management can generate considerable financial pressures (Aivaz, 2021a, p.54).

The literature suggests that there is a direct and complex relationship between turnover and cash flow, influenced by multiple financial and non-financial variables. Aivaz (2021b, p.32) highlights the impact that subsidy revenues can have on turnover in sectors such as agriculture, forestry and fisheries, signaling a positive correlation between these revenues and turnover growth. This, in turn, can lead to improved cash flow, conditional, however, on rigorous financial planning and prudent resource management (Aivaz et al, 2019, p. 116).

Financial risk, on the other hand, is a determining factor in the dynamics of turnover and, consequently, cash flow. Aivaz *et al* (2022, p.3) explore the links between transportation nonconformities and financial uncertainty in the context of the COVID-19 pandemic and armed conflicts, demonstrating how external uncertainties can negatively influence financial performance. Financial planning thus becomes a central tool in mitigating risks and supporting sustainable turnover growth with direct effects on cash flow.

The legislative and institutional context also plays a significant role in shaping economic behaviors and promoting sustainable development, which in turn affects the financial performance of entities. Brasoveanu (2023a, p.52; 2023b, p.44) discusses the impact of regional development on the environment and the role of legislation in supporting sustainable development, which also indirectly influence the financial performance of companies.

In conclusion, turnover growth can have a positive impact on cash flow, but this effect is conditional on the ability of entities to effectively manage financial risks and adapt to changing market and regulatory conditions (Aivaz, 2021c, p.18). Thus, financial success is dependent not only on internal management factors but also on a favorable and stable external environment (Munteanu *et al*, 2023; Stroie *et al*, 2023).

Turnover growth and its impact on cash flow is a complex topic that involves the assessment of many financial variables (Stan, 2021, p.227). Among them, the receivables turnover ratio and its impact on profitability was studied in detail by Afi and Falih (2024), who identified a significant correlation between receivables turnover ratio, cash turnover ratio and return on assets.

Also, the relationship between free cash flow and profitability was explored by Ahmed *et al* (2018), who observed that free cash flow has a positive impact on profitability in the pharmaceutical sector. This suggests that effective cash flow management can play a crucial role in improving the financial performance of a company.

In addition, the link between capital structure and financial performance is illustrated in the study by Affandi, Sunarko and Yunanto (2019), who analyzed the impact of various financial ratios such as cash ratio, debt to equity and debt turnover ratio on dividend payout ratio. Their results emphasize the importance of a balanced capital structure to support a generous dividend policy.

In the context of leadership changes, Adams and Mansi (2009, p.524) investigate the impact of CEO changes on the wealth of bond lenders, emphasizing that these changes can have significant effects on stakeholder value, including bond lenders. The interdependence between management decisions and the financial performance of companies is also demonstrated (Stan and Vintila, 2021, p.172).

Therefore, it is essential for managers to understand and integrate these various financial influences into their strategies to optimize financial performance and support the long-term sustainable growth of companies.

Today's highly globalized economy was flooded with liquidity during the period of the covid epidemic by all countries, which subsequently started to withdraw money supply from the market in order to limit the effects of excess inflation. In an attempt to limit the effects of high inflation, this money supply started to be withdrawn from the market and, as a result, some economies started to experience liquidity problems.

In order to avoid financial bottlenecks, economic entities have started to apply some measures to avoid default, which is not beneficial at all. That is why they have started to apply a number of measures in order to have liquidity. One of the measures has been to increase turnover which, theoretically, should provide a cash flow surplus, a surplus that can be the basis for expanding the business or at least keeping the business afloat.

This is why I have tried in this scientific endeavor to show how turnover influences the activity of an economic entity, especially since turnover is a very important indicator in the "healthy" activity of an economic entity.

3. Research methodology

In the methodology of our study, we employed the analytical research method, a critical approach aimed at uncovering detailed insights into specific topics. This method involves a systematic collection and examination of data to evaluate hypotheses or reinforce particular viewpoints. Initially, relevant data pertaining to the topic were gathered. Subsequently, this data underwent rigorous analysis to substantiate the ongoing research, enhance its credibility, and potentially spark new perspectives regarding the subject matter.

A significant component of our analytical approach was the comprehensive review of existing literature, which involved scrutinizing previously accumulated data related to our field of study (Brasoveanu, 2023, 56). This step is crucial as it helps in building a solid foundation for the research by integrating and reevaluating existing knowledge.

One important characteristic of the analytical research method is its adaptability in the face of new information. Unlike other methodologies, such as experimental research that can establish causality and thus provide robust evidence regarding the origins of a phenomenon, the analytical approach is inherently limited by the availability and completeness of data. This inherent limitation means that conclusions drawn from analytical methods are provisional and subject to adjustment with the acquisition of new or more comprehensive data (Rus, 2022, 1012).

Thus, the analytical method not only supports the validation of current research but also remains flexible enough to incorporate emerging data, making it a dynamic tool in the arsenal of scientific methods. This flexibility is critical, especially in fields where data is continuously evolving and expanding, allowing for ongoing refinement and enhancement of research outcomes.

4. Findings

4.1. Financial risks

Riscul financiar în cadrul unei entități economice reprezintă probabilitatea ca acea entitate să nu poată face față obligațiilor sale financiare, ceea ce poate duce la pierderi financiare, afectarea reputației sau chiar insolvență. Acest risc apare din diverse surse și este influențat de deciziile de finanțare, structurarea datoriilor și gestionarea fluxurilor de numerar.

Several types of financial risk are present in practice: <u>liquidity risk</u>, which arises when the economic entity does not have sufficient cash or liquid assets to cover its current obligations (inability to pay suppliers or employees on time), <u>credit risk</u>, which is that risk when the economic entity cannot repay debts incurred or has difficulty in obtaining financing (default on a line of credit), <u>interest rate risk</u>, which arises when fluctuations in interest rates can increase the cost of financing loans or lines of credit (rising interest on a mortgage loan affects profitability), <u>currency risk</u>, which is the type of risk that affects entities operating internationally or that have revenues and expenses in different currencies (the depreciation of a currency may increase the costs of imports) and <u>operational risk with financial impact</u>, which is the type of risk where losses may occur as a result of faulty internal processes, human error or external factors, affecting financial stability (an industrial accident may lead to significant losses).

Financial risk can be managed in the following ways:

- Diversification of funding sources - combining equity and debt financing to reduce reliance on a single source;
- Periodic cash flow analysis - careful planning of cash inflows and outflows to ensure liquidity;
- Hedging for currency and interest rate risk - the use of forwards, swaps or options to protect the firm from adverse fluctuations;
- Reducing excessive debt - maintaining a healthy equity to debt ratio;
- Building a reserve fund - liquid "wealth" for contingencies or financial crises, and
- Monitoring financial indicators - tracking indicators such as leverage, current liquidity or interest cover to detect potential problems early.

4.2. Impact of turnover on cash flow

Turnover is the total amount of sales made by a company in a given period. It has a significant impact on the economic entity's cash flow, which is the difference between cash receipts and cash payments.

Some of the ways in which turnover can influence cash flow are:

- Increased turnover - has a positive impact because higher turnover indicates higher sales volume, which can lead to higher cash receipts, improving cash flow, and these cash receipts need to occur in a short time frame to avoid cash bottlenecks;
- Link to payment terms - if an increase in turnover implies longer payment terms to customers, cash flow may become negative as the economic entity has to finance operating costs upfront and outstanding receivables may reduce cash flow even if turnover is high;
- Costs associated with sales - higher turnover can come with increased operating costs (raw materials, salaries, marketing, etc.), which can put pressure on cash flow; ineffective inventory or expense management can magnify this impact;
- Seasonality effect - in seasonal businesses, a sudden increase in turnover in a particular period can lead to cash imbalances, e.g. if receipts occur after the revenue-generating season, the economic entity needs to have sufficient cash reserves to cover current payments;
- Financing strategies - sometimes, economic entities may invest in business growth by extending credit to customers or by increasing marketing expenditures. This can temporarily lead to negative cash flow.

To optimize cash flow based on turnover I can make the following recommendations:

- ➢ Monitor receivables - track overdue payments and implement strict collection policies;
- ➢ Reduce payment terms - negotiate shorter terms for collections from customers;
- ➢ Inventory management - optimizing inventory to avoid tying up capital;
- ➢ Financial planning - creating a cash budget to anticipate seasonal fluctuations.

Financial planning is an essential process for ensuring effective management of financial resources, achieving strategic objectives and increasing long-term sustainability. It involves financial forecasting, efficient allocation of resources and continuous monitoring of economic performance.

The main stages of financial planning are:

- ❖ Setting financial objectives - consists of clearly defining short, medium and long term strategic objectives, i.e. increasing revenues, reducing costs, diversifying sources of income, investing in assets;
- ❖ Analysis of the current financial situation - consists of assessing available financial resources (cash, assets, liabilities), analyzing key financial indicators (profitability, liquidity, solvency, profitability) and identifying financial strengths and risks;
- ❖ Budgeting - consists of creating an annual budget reflecting operational and strategic plans and dividing it into categories such as: anticipated revenues, operating expenses (direct and indirect costs) and capital expenditures (investments in equipment, technology, etc.);
- ❖ Financial forecasting - consists of estimating future income and expenditure based on historical data and market trends and using scenarios to assess the impact of economic changes (optimistic, pessimistic, realistic scenarios);
- ❖ Allocation of financial resources - requires prioritizing investments according to expected returns and strategic objectives and maintaining a balance between operational expenditure and capital investment;
- ❖ Monitoring and Adjustment - consists of periodically analyzing financial performance against budget and targets, identifying deviations and taking corrective action, and redesigning the financial plan in line with economic and market conditions.

Good financial planning also has benefits such as **ensuring financial sustainability** because the economic entity avoids financial bottlenecks and optimizes the use of resources, **informed decision-making**, i.e. investment and spending decisions are based on sound analysis, risk prevention by **identifying and managing financial risks** before they affect the entity, and **increased investor and creditor** confidence because rigorous planning demonstrates that the entity is well managed.

Well-established financial planning that adheres to these steps and tools can only contribute to the success of a business entity, regardless of its size or scope of activity.

5. Conclusions

Turnover greatly influences the cash flow because, if other factors are taken into account, such as a decrease in operating expenses through technologization, re-engineering or outsourcing of certain processes in the economic entity's activity, then this increase in turnover generates additional cash flow and, last but not least, leads to an increase in the profitability of the economic entity.

An increase in turnover that is directly proportional to an increase in expenditure does not bring added value to the economic entity and account must also be taken of market factors that cause an artificial increase in turnover, such as inflation, increases in utility tariffs, increases in salaries, the price of raw materials, etc. This is why it is advisable to use, where possible, the scenario method mentioned above when establishing the prices of goods and/or services of the economic entity. Last but not least, the best possible recovery of receivables from customers.

In conclusion, turnover influences cash flow according to the speed of collection of receipts, the level of associated costs and the financing strategies used. Uncontrolled turnover growth without proper management of these factors can generate significant financial pressures.

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