Project Agreement number 2022-1-MT01-KA220-ADU-000086969
Financial Skills foR busiNEss Startups Smes - FAIRNESS

MODULE No: 1

Responsible Partners: South-West University "Neofit Rilski" & European Projects and Training OOD (EPT)

Title of the Module

Module Title	**M1: Entrepreneurship and financial tools management**
EQF-Level	**4/5**
Duration	**6 hours**
Unit 1 Title	**Entrepreneurship and Entrepreneurship Management**
Learning objective	The module aims at developing entrepreneurial and financial tools management skills and competence in entrepreneurs, assisting them in endeavor to do the appropriate management activities and improving their capacity to identify, select, manage and use the most appropriate financial tools to sustain the sustainable development of their enterprises. The objective of the module is to acquaint the learners with the essence of entrepreneurship and to transfer to the learners the appropriate knowledge and acquire the skills to start and successfully manage an enterprise/ business activity and the needed for it financial tools. It will allow them to manage unforeseen threats and the risks associated with the business and the financial tools, to analyze the environment around them and take suitable decisions about their product, to apply the managerial techniques in different management areas and launch their own enterprises, to understand and manage the basic knowledge on marketing, resource and financial management.
Knowledge	The learners will be in position to describe the essence and the main role and functions of entrepreneurship. They will further recognize and describe the main categories of entrepreneurship management skills and understanding the role, responsibilities and engagement of entrepreneurs. The learners can list and explain the use of the main management tools and approaches, to define, identify, describe, evaluate and select the most appropriate tools for the efficient business processes management and development.

Skills	She / he will be able to plan, organize and control the overall performance of one's own business; She / he will be able to plan and assign tasks, organize and manage working teams and apply control over their performance within his/her organization; She / will be able to generate innovation ideas; She / he will be able to apply problem solving approaches and techniques; She / he will be able to plan for medium and longer-term benefits for the business; She / he will be able to apply time management and business organizational measures within his/her company;
Competences	She / he will have the capacity to generate and select innovation ideas and further develop them into innovation entrepreneurial projects; She / he will have the capacity to choose appropriate measures and tools to implement marketing and networking activities for her/his business in order to make the enterprise business processes more effective and sustainable. She / he will choose the best customer service solutions; She / he will have the capacity to apply strategic planning actions and measures; She / he will have the capacity to improve effective communication and listening, being able to communicate effectively.
Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module(to be completed in later stage)*
Unit 2 Title	**Assessment, Evaluation and Selection of Financial Tools**
Learning objective	By completion of this unit the learners will be aquatinted with the main understandings how to manage financial tools. The learners will acquire the relevant knowledge and skills to understand, distinguish and manage the main financial tools to be used to support their business, enabling them to understand the fundamentals of how to select and use different financial tools, to analyze and interpret financial the most appropriate financial tools related to their business activity and how to effectively manage them.
Knowledge	The learners can identify the main types of financial tools, their applicability and potential, as well as accompanying risks.
Skills	She / he will be able to assess, evaluate, evert, minimize and general manage the risks inherent to all the entrepreneurial activities and as well as to the selection of the appropriate financial tools; She / he will be able to apply concrete assessment and evaluation methods in regards to the financial tools that are to be used.

Competences	She / he can select the appropriate financial assessment and evaluation methods and approaches in order to select the appropriate financial tool or portfolio of financial tools for one's own business.
Unit 3 Title	**Financial Tools Management**
Learning objective	By completion of this unit the learners will be aquatinted with the main understandings how to manage financial tools. The learners will acquire the relevant knowledge and skills to understand, distinguish and manage the main financial tools to be used to support their business, enabling them to understand the fundamentals of how to select and use different financial tools, to analyze and interpret financial the most appropriate financial tools related to their business activity and how to effectively manage them.
Knowledge	She / he can list and explain the main types of Financial Tools available and their relevance to the his/her business development; She / he will has a good knowledge awareness how to manage the most relevant financial tools; She / he will know how to improve financial tools management related to his/her business context.
Skills	She / he will be able to manage and use the most appropriate financial tools for his/her business; She / he will be able to improve simple and basic management rules to manage the financial tools identified and in comparison with his/her business activity; She / he will be able to search and identify the most appropriate and relevant financial tools for his/her business.
Competences	She / he will choose between financial indicators based on the analysed data; She / he will be have the capacity to evaluate alternatives among different financial tools available, in order to make the most effective possible decision; She / he will be have the capacity to implement and manage strategic financial planning and processes; She / he will be have the capacity to implement basic budgeting and accounting rules; She / he will select the appropriate methods and approaches how to effective manage the Financial tool identified and selected.
Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module(to be completed in later stage)*
Educational CONTENT for Learners to be trained:	
	Introduction:
Topic 1	**Entrepreneurship and Entrepreneurship Management:** **1.1. Essence of Entrepreneurship;** **1.2. Entrepreneurship Management: Approaches and methods**

Project Agreement number 2022-1-MT01-KA220-ADU-000086969
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Topic 2	**Assessment, Evaluation and Selection of Financial Tools**
Topic 3	**Financial Tools Management:** **3.1. Mains sources of funding (financial tools) for the small and medium-size businesses;** **3.2. Maximizing profit and wealth approach** **3.3. Minimizing risk approach in financial tools (sources of funding) management.**

Introduction

General Overview

Entrepreneurship has a key role in business life. It is beneficial for any business organization to understand its essence, sources, principles, features and role. It is important every entrepreneur to possess a set of specific knowledge, skills and competences. The entrepreneurial strategy is a practical and systematic approach for how to undertake the process of exploring and evaluating the core choices that entrepreneurs need to make as they translate their ideas into a reality.

Objectives of the Module

With the completion of this module, the learner will be able to uunderstand the meaning of "entrepreneurship" and "entrepreneur", to assess the qualities of an entrepreneur, to understand the concept of perseverance, to build self-confidence, to understand the pillars to turn its own business vision into reality. The module will transfer the knowledge to allow the learners to acquire full awareness on the meanings to develop and manage an enterprise, using process of identifying and starting a business activity, sourcing and organizing the required resources and taking both the risks and rewards associated with the business activity. The learner will also acquire the knowledge and develop its own skills and competences to optimize the use of financial resources, about scarce financial resources and rising costs.
The learners will be acquainted with the main features, functionalities and fields of applications and management of the available financial tools.

TOPIC 1: Entrepreneurship and Entrepreneurship Management

Main point 1.1. Title

Essence of Entrepreneurship

1.1 Main Content

Entrepreneurship has a key role in business life. It is beneficial for any business organization to understand its essence, sources, principles, features and role. It is important every entrepreneur to possess a set of specific knowledge, skills and competences. The entrepreneurial strategy is a practical and systematic approach for how to undertake the process of exploring and evaluating the core choices that entrepreneurs need to make as they translate their ideas into a reality.

1.1.1 Essence of Entrepreneurship

Definition of Entrepreneurship

As a fundamentally important part of our social-economic life, entrepreneurship has a key role for creation and successful development of business. The entrepreneurship involves a transformative process of social and market change creating value for individuals and society. Different authors suggest a variety of definitions of the entrepreneurship`s essence:

- Competitive behaviours that drive the market process (Kirzner, 1973, pp. 19-20);
- Process by which individuals pursue opportunities without regard to the resources they currently control (Stevenson & Jarillo, 1990, p. 23);
- Way of thinking, reasoning and acting that is opportunity-based, holistic in approach and leadership balanced. Entrepreneurship results in the creation, enhancement, realization and renewal of value for the owners, all participants and stakeholders (Timmons & Spinelli, 2004, p. 47);
- A key to successful practice begins with action and creation of new organization (Barot, 2015, p. 163);
- Entrepreneurial ability bringing innovation to the market through entrepreneurship process and learning (Hessels & Naudé, 2019, pp. 389-403);
- A natural phenomenon in business generating jobs opportunities and lead to economic development (Diandra & Azmy, 2020, p. 236).

The origin and sources of Entrepreneurship

The ground on which entrepreneurship steps and originates from are provided in Table 1.1 alongside with the authors who have provide the respective concepts.

Table 1.1 Sources and concepts of Entrepreneurship

Source of Entrepreneurship	Authors
Opportunity-based entrepreneurship	(Jinjiang, Nazari, Yingqian, & Ning, 2020)
Market-driven entrepreneurship	(Ali & Levie, 2019)
Entrepreneurial skills	(Bonney, Davis-Sramek, & Cadotte, 2016)
Entrepreneurship and innovation are creation of value	(Maritz & Donovan, 2015)
Entrepreneurship is shaped by digital technology, and at the end provides entrepreneurial opportunities	(Nambisan, 2016)
Entrepreneurship education used to transform society	(Ratten & Usmanij, 2020)

Principles of entrepreneurship

Process of the effective entrepreneurial decision-making is related to knowing the basic principles of the entrepreneurship:

- freedom in the choice of activity;
- right to carry out activities by individuals and legal entities;
- freedom in choosing business partners;
- autonomy in the formation of prices in accordance with the laws of the market economy;
- freedom in decision-making about business development, etc.;
- attracting the assets and funds of legal entities and citizens for the entrepreneurial activity;
- independent formation of an activity program, selection of suppliers, users of the released production, establishment of prices in accordance with the production costs in compliance with the current legislation;
- free hiring of workers;
- attraction and use of material, financial, labour, natural and other resources which use is not prohibited or not limited by legislation;
- free distribution of the profit remaining after payments, etc.

Features of Entrepreneurship

The main features and specifics of the entrepreneurship include:

- initiative;
- creativity;
- object oriented;
- risk taking;
- innovations;
- economic activity;
- economic and social responsibility;
- managerial and leadership functions independence;
- scale of thinking;
- business likeness.

Role of Entrepreneurship

Entrepreneurship is a driver of economic processes and one of the main reasons for the economy growth in the conditions of ever-increasing competition.

Entrepreneurship depends on individual motivations and experiences, socio-cultural factors and traditions, educational opportunities, availability of relevant skills and attitudes, supporting financial institutions and access to credit, existence of commercial trading centers, supporting infrastructure including trade routes with efficient transport and communication facilities, macroeconomic environment and overall political stability (Kalyan, 2018, p. 3756).

The role of the entrepreneurship can be summarized in the following main directions:

- economic growth;
- dispersal of economic power;
- increases national income;
- promotes capital formation;

- reduces concentration of economic power;
- promotes country's export trade;
- wealth creation and distribution;
- creates large scale employment opportunities;
- increase companies' performance;
- improvement in the standard of living;
- promotes balanced regional development.

Main point 1.2. Title

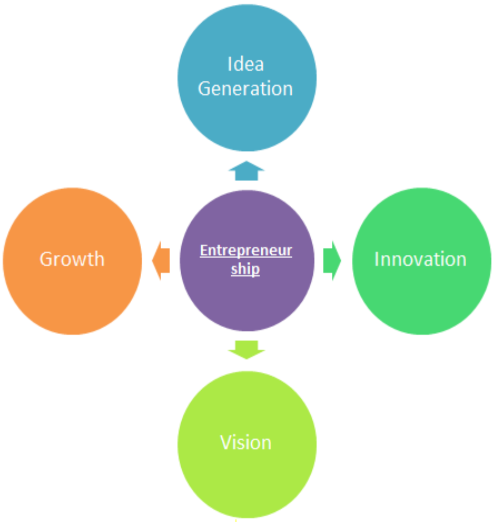
Entrepreneurship Management: Approaches and methods

1.2 Main Content

Entrepreneurship Management is a process defined as systematic method of handling activities. Management is some type of work or set of activities, a process involving certain functions and activities that managers perform. The purpose of management is to learn how to apply the different management principles and concepts at right circumstances at the right time to produce desired result.
The process of management consists of planning, organizing, directing and controlling the resources to ensure that resources are used to the best advantages of the organization. A single function alone cannot produce the desired results. Management involves continuous planning, organizing, directing and controlling.
The success of a family business comes through his ability to perpetuate through generations. The generational transition, understood as transfer of leadership and/or ownership of a business from one generation to the next, play therefore a crucial role for the success of the family business.
Family-run businesses generally represent medium or small-sized businesses that are characterized by continuous and prevalent collaboration of family members in the internal management of the business activity. However, these specificities are not sufficient to reduce the family business model to a homogeneous category. Furthermore, to date, a definition of family business that can be considered universally shared by academics has not yet emerged. In particular, the definitions of family business hinge on the following elements:
- Ownership and control of the company by the family;
- The number of family members involved in management;
- The number of generations that have succeeded one another at the helm of the company over time;
- The degree of involvement of family members with respect to company succession.

Inserting professionals who are not part of the founding family into top roles is certainly a difficult decision, but it can also prove to be a necessary strategic choice.
if a suitable figure cannot be found within the family, the possibility of turning to an external manager should be considered. A painful decision, which of transferring part of the company control outside the family, which often involves a necessary cultural change.
The involvement of external managers typically has positive effects on performance because, when it is necessary to make decisions for the company, an external manager typically does so with greater objectivity or in any case with less emotional involvement than a person within the family at head of the company.
The two main challenges that make the process of professionalising the family business through the use of managerial intervention particularly difficult are:

1. the family's ability to delegate, which must ensure that the professional "embraces" the objectives of the family business but must then leave him the necessary autonomy to exercise his professionalism; this is obviously only possible in the presence of strong trust between family and manager;
2. the implementation of a cultural change within the company in which any change in family involvement from a management role to an ownership and/or governance role is not seen as a step backwards but as a different necessary structure to successfully govern the evolution of the family business; understanding that family involvement can change over time depending on the temporal evolution of the family business is important for the future of the company.



Entrepreneurship management within a small family run business can be identified in the internal organization of the company, which regulates the relationships between the subjects who different titles are involved in carrying out the activity and which aims to protect the different interests involved. The objective of these rules is to protect good management and, at the same time, the interests of shareholders, creditors and employees.
An effective Management represents the effective and real vision of the company, it constitutes the truth tool designed to ensure that company management can make correct decisions, without risk making mistakes and avoiding risks or costly delays.
The management process occurs through the acquisition and use of resources necessary in an effective and efficient manner, carrying out a continuous comparison regarding this that has been achieved and what was intended. Therefore, the necessary resources must be obtained and used in an efficient and effective manner. By efficiency, we mean the company's propensity to optimize quantities of resources necessary to achieve a given volume of output. On the contrary, the effectiveness represents the ability of a company to optimize the fruits coming from the company's outputs management. For measuring these factors, there are specific indicators:

- As far as efficiency is concerned with something that can be measured as the ratio between the production achieved and the production factors used to achieve it. Such factor expresses the maximum level of performance and productivity achievable with the factors employed, minimizing the resources necessary to achieve a given result. It can be evaluated in final terms: with results obtained against resources actually used; or in scheduled terms: relationship between expected results and planned resources.

- Regarding the effectiveness of the programs used, they can be evaluated as relationship between the result obtained and the expected objective, so that a comparison is possible among these data, it is always necessary to pre-establish objectives.

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The entrepreneurship Management provides several different processes and tools as follow:
Management aims at achieving predetermined objectives: All organizations have objectives that are laid down. Every managerial activity results in achievement of these predetermined objectives.
Management as decision-making: Decision-making is selecting the best among alternative courses. Decision-making is an important function of a manager. Whatever a manager does, he does it by making decisions. The success or failure of an organization depends upon the quality of decision. A manager must make a right decision at right time.
Management at all levels: The functions of management are common to all levels of organization. The functions of planning, organizing, directing, controlling, decision-making are performed by top level as well as lower level supervisors.

Strategic planning
Strategic planning corresponds to a reflection process carried out by company management in order to first define the strategic objectives that the company intends establish, through a clear, even if not detailed, determination of implementation plans, divided among the various company sectors. Therefore, strategic planning is about deciding overall objectives and policies objectives that the company intends to set itself, taking into consideration any changes to be adopted and the resources to be committed to achieving them. Includes extensive content, such as the end markets, the nature of the products and the technologies used in production and has an extended time horizon, typically 5 or more years.
Business planning is divided into 3 different types based on the time horizon to which it refers:
1. Strategic: long term, concerns the actual future of the company, over 5 years
2. Tactics: medium-term period, from one to five years
3. Operational: objectives and operations referring to the short term, period within the year.
Effective planning does this to give durability and competitiveness to the company and is usually divided into 5 phases:
1) Initial environmental analysis: the first planning step concerns the market analysis competitive environment in which the company operates, in order to identify particular opportunities economic and avoid possible dangers present. Some factors will be analysed key to determining the economic ecosystem such as: the level competitiveness, the availability of raw materials and the state of technological innovation of other companies.

2) Business analysis: identification and analysis of weak and strong points of the company, the so-called SWOT analysis, in consideration of some characteristics corporate such as: cash flow management capacity, market shares held, level of the product offered and the production processes used as opposed to those used by competitors.
3) Definition of general objectives, this phase is closely linked to the analysis environmental and business analysis, as the general objectives of a company must be commensurate and suitable to the possibilities that exist in the surrounding environment, understood as an economic panorama, and must be compatible with the possibilities production of the company itself.
The future achievement or failure of the overall objectives depends on how large they are been adapted based on the analyses described above, the more meticulous the studies regarding the internal and external environment of the company will have been, plus the information provided to decision makers will be in line with the objectives that are actually achievable.
4) Company policies, set of actions aimed at achieving general objectives pre-established. They can be considered binding both as regards the guideline to be followed by the company operators, and for any corrective moves implemented in during the course of the work, these must be aimed at achieving and consolidating the pre-established economic policies.
5) Formulation of the plan, final phase of strategic planning within the company, which establishes in detail the timing and methodologies to be adopted for the achievement of general objectives. As already mentioned, the plan usually lasts of 5 years or more, but within it there may be six sub-objectives, which serve to monitor the progress of the results obtained in relation to the final objectives.

Nature of Entrepreneurship Management

The principles, concepts and techniques of management have changed over the period of time. Various contributions to the field of management have changed its nature. The nature of management can be described as follows:

- *Multidisciplinary*: Management is multidisciplinary. It draws freely ideas and concepts from the disciplines like economics, sociology, psychology, statistics, operations research etc. Management integrates the ideas taken from various disciplines and presents newer concepts which can be put into practice. The integration of these ideas is the major contribution of management.
- *Dynamic nature of principles*: A principle is truth which establishes cause and effect relationships of a function. Principles are developed by integration of ideas from various disciplines supported by practical evidence. These principles are flexible and change with the environment in which organization works. Continuous researches are being carried on to establish new principles; many older principles are changed by new principles. There is nothing permanent in management.
- *Relative not absolute principles*: Management principles are relative and not absolute. They must be applied according to the need of the organization. Each organization is different from other. The principles of management should be applied in the light of prevailing conditions.
- *Universality of management*: Management is universal phenomena. Though universal yet management principles are not universally applicable but are to be modified according to the needs of the situation.

Management Functions or the process of Management

List of Management Functions

Planning	Directing	Controlling
Formulating purpose	Leading	Investigating
Decision making	Motivating	Evaluating
Innovating	Commanding	Coordinating
Organizing	Activating	Representing
Staffing	Securing Efforts	Administration
Appraising	Communicating	

The list of management functions is too long. However it can be shortened by combining some functions into one. For example, leading, motivating, communicating and commanding may be combined into a single function namely directing. For our purpose we shall designate the following five as the functions of the manager. In addition, we briefly refer to "Innovation and representation as two additional managerial functions.

Planning: Planning is the primary function of management. It is looking ahead and preparing for the future. It determines in advance, what should be done. It is conscious determination of future course of action. This involves determining why to take action? What action? How to take action? When to take action? Planning involves determination of specific objectives, programs, setting policies, strategies, rules and procedures and preparing budgets. Planning is a function, which is performed by managers at all levels – top, middle and supervisory. Plans made by top management for the organization as a whole may cover periods as long as five to ten years, whereas plans made by low-level managers cover much shorter periods.

Organizing: Organizing is the distribution of work in group-wise or section wise for effective performance. Once the managers have established objectives and developed plans to achieve them, they must design and develop a human organization that will be able to carry out those plans successfully. Organizing involves dividing work into convenient tasks or duties, grouping of such duties in the form of positions, grouping of various positions into departments and sections, assigning duties to individual positions and delegating authority to each position so that the work is carried out as planned.

Staffing: Staffing involves managing various positions of the organizational structure. It involves selecting and placing the right person at the right position. Staffing includes identifying the gap between manpower required and available, identifying the sources from where people will be selected, selecting people, training them, fixing the financial compensation and appraising them periodically. The success of the organization depends upon the successful performance of staffing function.

Controlling: Planning, organizing, staffing and directing are required to realize organizational objectives. To ensure that the achieved objectives confirm to the preplanned objectives control function is necessary. Control is the process of checking to determine whether or not proper progress is being made towards the objectives and goals and acting if necessary to correct any deviations. Control involves three elements:

(a) Establishing standards of performance.

(b) Measuring current performance and comparing it against the established standard.

(c) Taking action to correct any performance that does not meet those standards.

Directing: Planning, organizing and staffing functions are concerned with the preliminary work for the achievement of organizational objectives. The actual performance of the task starts with the function of direction. This function can be called by various names namely "leading", "directing", "motivating", "activating" and so on. Directing involves these sub functions:

(a) Communicating: It is the process of passing information from one person to another.

(b) Leading: It is a process by which a manager guides and influences the work of his subordinates.

(c) Motivating: It is arousing desire in the minds of workers to give their best to the enterprise

Table 1: Entrepreneurial management functions

Management Functions	Entrepreneurial Management
Planning	Establishing goals and ways of achieving them
Organising	Arranging people and work to accomplish objectives
Staffing	Managing various positions of the organizational structu
Controlling	Encouraging the human factors in performance
Directing	Making sure performance conforms with plan

Functional Areas of Management

Management process involves several functions. A distinction should be maintained between management functions (planning, organizing, staffing, directing and controlling) and the organizational functions (productions, finance etc.) Organizational functions differ from organization to organization depending upon their nature while management functions are common to all. A manager may be put in either production or finance or marketing, he performs all the managerial functions. These organization functions are called functional areas of management. There are four functional areas of management namely production, finance, marketing and finance and personnel. Each functional area may have a number of sub-activities.

Production: This is generally put under production manager and he is responsible for all production related activities. This area has a number of activities, few of them are given below:

(1) *Purchasing*: Which is related with the purchase of various materials required by the organization. Purchasing involves procuring right quantity of materials at the right quality, at the right time and at the right price from the right supplier.

(2) *Materials management*: This involves storing of materials, issue of materials to various departments.

(3) *Research and Development*: It deals with improving the existing products and process and developing new products and process.

Marketing: This area involves the distribution of organizations' products to the buyers. The sub-activities are:

(1) *Advertising*: Involves giving information about products to buyers.

(2) *Marketing research*: It is related with the systematic collection, analysis of data relating to the marketing of goods and services.

(3) *Sales management*: It involves management efforts directed towards movement of products and services from producers to consumers.

Finance and accounting: It deals with intelligent investment of financial resources and record-keeping of various transactions. The various sub-functions are:

(1) *Financial Accounting*: Deals with record keeping of various transactions.

(2) *Management Accounting*: Deals with analysis and interpretation of financial records so that management can take certain decision.

(3) *Costing*: It deals with recording of costs, their classification and analysis for cost control.

(4) *Investment Management*: Takes care of how financial resources can be invested in various alternatives to maximize returns.

(5) *Taxation*: Deals with various direct and indirect taxes to be paid by the organization

Personnel: It deals with the management of human resources with the following sub-activities:
(1) *Recruitment and Selection*: It deals with recruitment and selection of employees.
(2) *Training and Development*: It deals with training of employees and making them more efficient.
(3) *Wage and Salary Administration*: Deals with fixing of salaries, job evaluation, promotion, incentives etc.
(4) *Industrial Relations*: Deals with maintenance of good employee relations.

Management Control

Essential tool for verifying the correct performance of each department, sector or resource used in production activity. The control is divided into three distinct moments:
1) Prior control or budgeting,
2) Concomitant control
3) Subsequent control.

Antecedent control concerns the establishment of short-term objectives and useful budgets to realize them. This phase represents the one just described, that is, that of programming. It usually consists of various indicators, including efficiency ones and effectiveness.

The second, concurrent, phase of control is that phase of control which concerns verification and the evaluation of the business plans achieved, is defined as "concomitant" as it is implemented during the actual economic cycle of the company and concerns:

- The periodic collection (weekly, monthly quarterly, etc.) of indicators, which occurs through the calculation of direct and indirect costs and the related results;
- The communication of the information collected through the indicators to the centers competent responsibilities and to company management in the form of reports.
- Responsibility centers or managers, after receiving the information have the task of proposing corrective actions in case of deviations between actual results achieved and expected results.
- Execution of the choices promoted to fill production gaps.

Thanks to this control phase, managers are able to monitor the progress of its activity using the feed-forward approach in time periods pre-established, modifying any gaps, and thus avoiding failure achievement of objectives.

Finally, there is the subsequent control. It is the final phase of management control and occurs at the end of the production cycle following the feedback approach. It is the moment when the final data coming from the final measurements of the indicators are delivered to the responsibilities centres or top management. At this point the control cycle39 ends and the communications provided to management have a dual purpose:
a) Support the bases for opening the relevant prior control phase the following control and budgeting cycle.
b) Convey a truthful image of the company to managers, who through it study of the reports provided can verify the exact achievement or failure of the short-term objectives set.

TOPIC 2: Assessment, Evaluation and Selection of Financial Tools

Main Point 2.1 Title

Financial Assessment and Evaluation Methods

2.1. Main Content

The selection of financial tools can be made by the use of several basic financial assessment and evaluation methods. These methods are part of the so-called cost-benefit evaluation analysis of the use of the financial tools and they include:
(i) preparation of financial tool cost estimates;
(ii) forecasting incremental for the use of the certain financial toll net cash flows;
(iii) determining the appropriate discount rate, usually the weighted average cost of capital (WACC);
(iv) calculating the financial net present value (FNPV) at the WACC and the financial internal rate of return (FIRR), the discount rate at which FNPV is equal to zero; and
(v) undertaking risk and sensitivity analysis.
The real value of future cash flows is computed by eliminating the impact of inflation. Nominal prices (also referred to as current prices) always include the impact of general price inflation, and real prices (also referred to as constant prices) are derived from nominal prices by removing this impact.
Real value of cash flows are expressed as of a particular base year by removing the impact of inflation from the nominal value of cash flows in future years. For example, if the operating cost in 2015 was $100,000 for a given activity level, and the general price inflation was 3% per annum, the nominal operating cost in 2027 will be 112 550 Euros for the same activity level (inflation of 3% per annum compounded for 4 years) due to the impact of inflation. However, the real operating cost, expressed in 2023 prices, does not change—it is still 100,000 Euros . Mathematically, the relationship between real and nominal prices can be expressed as follows:

$$Pr = \frac{Pnt}{(1+i)^t},$$

Where:
Pr = real price; Pnt = nominal price in time interval “t”;
i = general inflation rate in percentage;
and t = time interval.

Preparation of a Business Project Cost Estimates:
A business project cost estimates should be prepared during the business project planning and preparation stage in concern with the use of one or another financial tool for the funding this very same project with sufficient detail to enable the user to understand the principal project cost components and enable efficient project cost control during implementation. Cost estimates comprise of three parts:
(i) base cost including taxes;
(ii) physical, price, and other contingencies; and
(iii) financial charges during implementation. Only the base cost including taxes and physical contingencies are considered in the cost–benefit evaluation, and the remaining cost components are not considered.

Forecasting Incremental Business Project Net Cash Flows:
Business project cash flows comprise inflows and outflows expressed in real terms. The net cash flow is the difference between inflows and outflows.
(i) Where there is an increase or addition to the existing network of assets, the project is incremental in nature (e.g., expansion of an electricity distribution network). Incremental cash flows represent the

difference between "with project" and "without project" scenarios.
(ii) For new projects, the entire cash flow will be incremental.
(iii) For replacement projects, the cash flows will be incremental, after setting off any disposal costs of the existing facilities, and any retraining of staff.
Cash inflows include revenue tariff and other sources, and cost rebates due to improved processes or more efficient equipment or system design.
Cash outflows include all costs incurred to construct (including physical contingencies), operate, and maintain the project facilities over the projected economic life. All taxes applicable to the project such as taxes on imports, value added taxes, goods and services tax, or similar should be included. Taxes payable on earnings (income tax or its equivalent) should be computed based on operating incomes (i.e., after depreciation but without considering the financial charges) in nominal terms and converted into real terms by discounting with the inflation factor.
Any additional costs to be incurred after commissioning should also be estimated along with the year(s) in which they will be incurred (e.g., replacement of inverters in a renewable energy project, periodic maintenance for roads, or final restoration costs at the time of project closure in a nuclear power plant).
Net revenue cash flows comprise inflows from delivery of services, and outflows for operations and management (O&M), which comprise variable and fixed costs including taxes. Incremental cash flows may sometimes comprise savings due to more efficient operation (e.g., reduction in nonrevenue water, or reduced fuel consumption in power generation due to substitution of fossil fuel generation with renewable sources such as wind or solar).
The sources of incremental cash flows need to be evaluated to confirm the degree of reliability and reasonableness. For tariff, user fees, or tolls, at a minimum, the following should be considered:
(i) governing laws, policy, or regulations;
(ii) any anticipated policy and regulatory changes;
(iii) historical trend of adjustments (at least 5 years);
(iv) whether the objective is only full cost recovery or cost recovery plus profit; and
(v) evaluation of the tariff, user fee, or toll in line with its objective, e.g., comparison of wastewater tariff against treatment costs.
Cash flow forecasts should be based on reasonable assumptions and prepared in consultation with the executing agency and/or implementing agency, if there is such an agency of the respective funding authority for the business project. Sometimes optimistic revenue projections are made to demonstrate project financial viability. The reasonableness test will be to compare the results based on such assumptions with the historical track record. Very high increases or profit percentages may be unrealistic, as the government or regulator is unlikely to permit them. The assumptions will include, among others, exchange rates used, applicable tariff, user fee or toll charges and the methodology for their determination and revision; demand; basis for estimating O&M costs; income and business taxes; and depreciation rate. Forecasts should be updated, at the minimum, after any material change of scope and additional financing, at midterm review and at completion. The updated forecasts provide information on the potential financial impact of the implementation issues.
Determining the Discount Rate
The WACC is the cost at which the project financing will be secured. WACC is used as the discount rate to estimate the FNPV of the project cash flows. The WACC is based on the financing plan for the project and computed only for the project sources of financing, and not for the entity.
There are many principles for estimating the cost of different sources of financing. The main principles are

discussed briefly as follows.

• **Debt with fixed interest rates.** Fixed interest rate remains unchanged for the life of the debt, irrespective of market conditions (e.g. bank loans). The cost of debt will include the interest, service charges, commitment fees, front-end fees, maturity premium, and any other charges, as defined in the debt contract.

• **Debt with variable interest rates.** Variable interest rates respond to market movements and change during the life of the debt (e.g., some banks' flagship loan product is presently linked to the 6-month London Interbank Offered Rate (LIBOR)). A fixed swap rate for the corresponding tenor should be considered. The LIBOR fixed swap rate corresponding to the average maturity of the project loan can be taken as a proxy for the likely average cost over the life of the loan. If the exact tenor is not published by the Treasury, the project team may apply the nearest period for which a rate is available or seek assistance from the Treasury to obtain the relevant rate. The indicative LIBOR fixed swap rate published by ADB's Treasury Department should be adjusted for lending spreads and other charges.

• **Equity.** Unlike debt, the cost of equity is not explicit. Equity is risk capital that absorbs all losses, and its cost should represent the opportunity cost of capital for the government or other equity investor. As most borrowing DMCs run a fiscal deficit, they need to borrow to invest in capital projects. Hence, all government financing (equity or grant) is at a cost, which cannot be less than the government's cost of borrowing, adjusted for tenor of investment and a premium for the risks associated with the project.

o For fully government-owned projects, a proxy can be the comparable interest rate for highly liquid government bonds (e.g., 10-year treasury bonds), which is the risk-free rate, adjusted for tenor and project risks.

o For projects that are implemented with private sector participation (e.g., public–private partnerships), the cost of equity needs to be assessed based on market considerations, since the investors will have several investment options.

o Grants also have an opportunity cost. While the equity has an expectation of returns, no such expectation can be attributed to grant funds. For this reason, the cost of grant funds can be estimated as equal to the comparable interest rate for highly liquid government bonds (e.g., 10-year treasury bonds) adjusted for project tenor, without any adjustment for project risks.

Calculating the Financial Net Present Value and the Financial Internal Rate of Return:

The FNPV is the difference between the present value of cash inflows and outflows over the projection period. The cash flows for a project comprise capital costs; operational revenue; operational expenditure; and additional investments in working capital (e.g., inventory, accounts receivable and payable). Financial charges and noncash transactions, such as depreciation, are to be excluded. All forecasted cash flows generated over different time horizons are discounted at the WACC to the present time when the analysis is being performed to eliminate the time value of money. The discounted value is more commonly known as the present value. The sum of all these annual present values of cash flows is the FNPV. Table 2 illustrates the methodology for computing the present value of money.

Table 2: Present Value of Money

Details	Year 1 (t_1)	Year 2 (t_2)	Year 3 (t_3)
Amount invested at the beginning of the year (t_0)	100	110	121
Interest rate	10%	10%	10%
Value after 1 year	110	121	133
Present value at t_0 of 110 that will be received in year 1	100	–	–
Present value at t_0 of 121 that will be received in year 2	100	–	–
Present value at t_0 of 133 that will be received in year 3	100		

Source: Asian Development Bank.

In mathematical notation, the FNPV formula is expressed as:

$$FNPV = -Co + \frac{C1}{(1+r)^1} + \frac{C2}{(1+r)^2} + \cdots + \frac{Ct}{(1+r)^t},$$

Where:
Co = initial investment,
Ct = net cash flow in time period t,
r = discount rate and
t = time. FNPV may be calculated manually using this formula or using the Excel function "NPV."
Table 3 shows an example of FNPV calculated manually.

Table 3: Calculating Net Present Value

Item	20X0 Outflow	20X1 Outflow	20X2 Inflow	20X3 Inflow	20X4 Inflow
Annual projected net cash flows	−200	−150	+75	+100	+300
Discount rate (10%)	1.10	1.11	1.12	1.13	1.14
PV of annual net cash flows	−200.00	−136.36	+61.98	+75.13	+204.90
FNPV (sum of all PVs)	+5.14				

FNPV = financial net present value, PV = present value.
Source: Asian Development Bank.

The financial Internal Rate of Return (FIRR) is the discount rate at which the FNPV becomes 0. The mathematical notation for FIRR is as follows:

$$0 = NPV = \sum_{t=1}^{T} \frac{C_t}{(1+IRR)^t} - C_0,$$

where:
C_t = Net cash inflow during the period "t" ;
C_0 = Total initial investment costs;
IRR = The internal rate of return;
t = The number of time periods.
The internal rate of return (IRR) is a metric used in financial analysis to estimate the profitability of potential investments. IRR is a discount rate that makes the net present value (NPV) of all cash flows equal to zero

in a discounted cash flow analysis.
IRR calculations rely on the same formula as NPV does. Keep in mind that IRR is not the actual dollar value of the project. It is the annual return that makes the NPV equal to zero.
Generally speaking, the higher an internal rate of return, the more desirable an investment is to undertake. IRR is uniform for investments of varying types and, as such, can be used to rank multiple prospective investments or projects on a relatively even basis. In general, when comparing investment options with other similar characteristics, the investment with the highest IRR probably would be considered the best. Unlike FNPV, this cannot be calculated manually given the complexity and iterative nature of the computation. FIRR is best calculated using the Excel function "IRR.".

A project is financially viable if its FNPV discounted at the WACC is positive, and the FIRR is greater than the WACC. A positive FNPV indicates an investment which generates sufficient incremental cash flows to recover its costs (excluding debt service). If the FIRR exceeds the WACC, then the project's cash flows will be adequate to fully service the capital, and the project is financially viable.

Risk and Sensitivity Analysis:
The financial cost–benefit evaluation is performed on the most likely scenario (the base case). However, it is only an estimate. The potential risks to the outcome and their impact on the FIRR and FNPV need to be evaluated. Risks need to be assessed in terms of severity of impact and probability of occurrence. The sensitivity of the project performance (FNPV, FIRR) to such risks should be assessed. Common risks include capital cost overrun, time overrun, delays in tariff revisions, lower demand, and underachievement of project objectives. The risk and sensitivity analysis may be divided into the following steps:

(i) identify risk events or risk factors,
(ii) determine severity of impact and probability of occurrence,
(iii) calculate the effect of the impact on base case FNPV and FIRR, and
(iv) summarize results and identify mitigating actions.

Some risks cannot be easily mitigated; these are identified by conducting a sensitivity analysis (e.g., risks that are beyond the project's control). In such cases, measurable covenants need to be designed to provide early warning to the government, to the executing agency and/or implementing agency, and/or to the respective EU funding authority. Sensitivity analysis is the determination of how the movement of an independent variable affects a dependent variable for a given set of assumptions. The switching value is defined as the percentage change in the independent variable to reduce the FNPV to 0. The sensitivity indicators and switching values provide an objective guide to assessing key risks and designing mitigation measures and covenants.
The sensitivity of the FNPV can be expressed numerically as sensitivity indicator and switching value. The sensitivity indicator expresses the ratio of change in FNPV to the ratio of change in a variable. For example, if the tariff (variable) is reduced by 10%, the FNPV declines by 67%, therefore the sensitivity indicator is 6.70 (67/10). The switching value is the reciprocal of the sensitivity indicator. A decline of 14.9% (1/6.7) in the tariff will reduce the FNPV to 0.
The sensitivity of the FIRR can also be numerically expressed in terms of sensitivity indicator and switching value. The sensitivity indicator compares the change in FIRR above the WACC to the percentage change in the variable. For example, if the base case FIRR is 15.87% and the WACC is 12%, and FIRR declines by 2.56% (from 15.87% to 13.31%) for a 10% decline in tariff, the sensitivity indicator is 6.61 (0.0256 /

0.0387) * (10). The switching value is the reciprocal of the sensitivity indicator and is 15.1% in this case. Thus, a 15.1% decline in the tariff will reduce the FIRR to WACC.

The sensitivity analysis may identify one or more risks that could be serious for the project's financial viability. For instance, a delay in tariff revisions, lower than anticipated offtake or less than anticipated improvements in efficiency, may undermine anticipated cash flows. If there is higher probability of occurrence of such risks, such risks should be rated as substantial or high, reported in the RRP together with suitable mitigation measures, and monitored during implementation.

Some examples of risk mitigation:

(i) restructure the financing plan to reduce WACC;
(ii) change the project scope; and/or
(iii) re-evaluate cost estimates, e.g., cheaper ways of implementing project.

TOPIC 3: Financial Tools Management

Main Point 3.1 Title

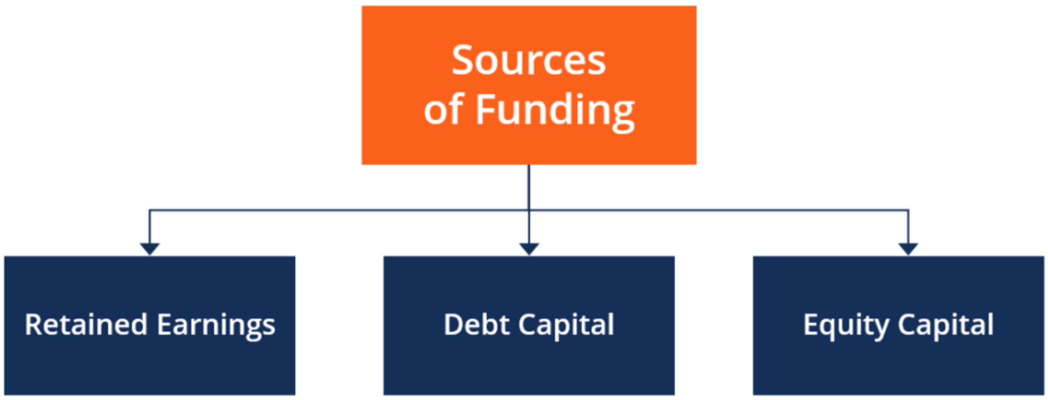
Mains sources of funding (financial tools) for the small and medium-size businesses

3.1. Main Content

What are Sources of Funding?

Companies (SMEs) always seek sources of funding to grow their business. Funding, also called financing, represents an act of contributing resources to finance a program, project, or need. Funding can be initiated for either short-term or long-term purposes. The different sources of funding include:

- Retained earnings
- Debt capital
- Equity capital



Source: https://corporatefinanceinstitute.com/resources/accounting/sources-of-funding/, last retrieved 20.11,.2023

Summary:

The main sources of funding are retained earnings, debt capital, and equity capital.

Companies use retained earnings from business operations to expand or distribute dividends to their shareholders.
Businesses raise funds by borrowing debt privately from a bank or by going public (issuing debt securities).
Companies obtain equity funding by exchanging ownership rights for cash coming from equity investors.

Retained Earnings

Businesses aim to maximize profits by selling a product or rendering service for a price higher than what it costs them to produce the goods. It is the most primitive source of funding for any company.
After generating profits, a company decides what to do with the earned capital and how to allocate it efficiently. The retained earnings can be distributed to shareholders as dividends, or the company can reduce the number of shares outstanding by initiating a stock repurchase campaign.
Alternatively, the company can invest the money into a new project, say, building a new factory, or partnering with other companies to create a joint venture.

Debt Capital

Companies obtain debt financing privately through bank loans. They can also source new funds by issuing debt to the public.
In debt financing, the issuer (borrower) issues debt securities, such as corporate bonds or promissory notes. Debt issues also include **debentures**, issuing of **capital bonds**, leases, and mortgages. Debt capital also includes such financial tools as **bank loans**, **overdrafts**, issuing **of bank guarantee**s and etc.
Companies that initiate debt issues are borrowers because they exchange securities for cash needed to perform certain activities. The companies will be then repaying the debt (principal and interest) according to the specified debt repayment schedule and contracts underlying the issued debt securities.
The drawback of borrowing money through debt is that borrowers need to make interest payments, as well as principal repayments, on time. Failure to do so may lead the borrower to default or bankruptcy.

Equity Capital

Companies can raise funds from the public in exchange for a proportionate ownership stake in the company in the form of shares issued to investors who become shareholders after purchasing the shares.
Alternatively, private equity financing can be an option, provided there are entities or individuals in the company's or directors' network ready to invest in a project or wherever the money is needed for.
Compared to debt capital funding, equity funding does not require making interest payments to a borrower.
However, one disadvantage of equity capital funding is sharing profits among all shareholders in the long term. More importantly, shareholders dilute a company's ownership control as long as it sells more shares.

Other Funding Sources

Funding sources also include **private equity, venture capital, donations, grants, and subsidies** that do not have a direct requirement for return on investment (ROI), except for private equity and **venture capital**. They are also called "**crowdfunding**" or "**soft funding**".
Crowdfunding represents a process of raising funds to fulfill a certain project or undertake a venture by obtaining small amounts of money from a large number of individuals. The crowdfunding process usually takes place online.

Main Point 3.2 Title

Maximizing profit and wealth approach

3.2. Main Content

What are the main Objectives of Financial Management?

Objectives of the Financial Management are broadly categorized into following below mentioned:

Profit Maximization

The main aim of any form of business is to earn a profit. All the business entity operates to earn the maximum amount of return in terms of profits. Profit earning capacity is a measuring technique to evaluate the efficiency of the concerned business. Profit Maximization is the traditional and narrow approach that aims to maximize the profit for an organization.

Wealth Maximization

Wealth maximization is also called as value maximization or net present worth maximization. This objective of Financial Management is universally acceptable in all forms of business concern. It's one of the modern approaches that involve the latest innovations and improvement in the fields of business operations. The term wealth means shareholders' wealth or the wealth of the persons involved the business concern.

<u>Features of Profit Maximization</u>

Profit Maximization consists of the following features:

Profit Maximization is also known as cash per share maximization. It helps in achieving the objects to maximize the business operation for profit maximization.

The ultimate objective of any business is to earn a huge amount of return in terms of profit. Thus, this objective of financial management considers all the possible ways to increase the profitability of the business concern.

Profit earning capacity is kind of a parameter for measuring the efficiency of a particular business. Thus, it shows the entire position of business along with the measures to improve and increase profitability.

Profit Maximization is an objective that helps in reducing risk.

Arguments in the favour of Profit Maximization

When earning the profit is the only motive of doing the business, the objectives to achieve those targets should be considered feasible; therefore, profit maximization should be the obvious objectives.

Profit earning capacity is the barometer for measuring efficiency and economic prosperity of business concern, thus this objective is justified based on rationality.

Economic and business situations don't go the same all the time. There are at times adverse business conditions like recession, depression, severe competition, etc. During these situations earned profit works as a saviour. Thus, a business should earn more and more profit at the time of a favourable situation. A business entity will be able to survive under unfavourable situations only if it has certain funds in the form of past accumulated earnings that it can rely upon.

The main source of income and funds for the business is the amount of profit earned. Thus, a business should aim to maximize its profit for enabling its growth and development.

The fulfilment of social goals is also achieved by earning the expected amount of profit. A business concern by pursuing the objects of maximizing the profit also maximizes socio-economic welfare.

In financial tools management, i.e. in management of the main sources of funding for one business (SME), the profit maximizing approach is aimed at finding and securing of such financial tools (source of funding) which will provide:

(i) the payment of minimum price for the use of the attracted financial capital; and

(ii) the earning of maximum profits on the business activities performed

at a certain level of acceptable risk and in a situation of all other conditions being equal.

Drawbacks

Irrespective of profit maximization being the best objective as it maximizes the owner's economic welfare, this objective is being rejected from practice due to the following drawbacks:

Ambiguity:

This objective is ambiguous as profit means different things for different people. Should it mean long term profit or short-term profit? Or we shall consider total profit earned or only earnings per share are sufficient. Profit before tax is considered or the one after tax.

Ignores the time value of money

Profit Maximization objective does not consider the time value of money and ignores the magnitude and timings of earnings. It treats all earnings similar irrespective of the fact that those income has occurred in different periods. It ignores the fact that cash received today has more value than the same cash received in previous years.

Ignores risk factor

While considering the objective of profit maximization, it does not consider the fact of risk involved in the prospective earning streams. Like some projects are riskier than the other. Two firms can have the same expected earnings per share but in case of earning a stream of anyone is riskier than the market value of its share would be comparatively less.

Dividend Policy

The effect of dividend policy on its market value of the share is also not considered in the objective of profit maximization. If the object of the firm is to increase earnings per share then an enterprise may not be considered paying a dividend because it can be satisfied by retaining all the profit in the business or investing it in the market.

TOPIC 3: Financial Tools Management

Main Point 3.2 Title

Minimizing risk approach in financial tools (sources of funding) management

3.3. Main Content

The essence of this approach is to search and build a portfolio of financial tools (sources of funding for the SME's business project which carry the lowest possible risks at a given price for use of the attached capital in a situation of all other conditions are equal.

Financial risk is often unavoidable in business. Sometimes, it's even acknowledged as a necessary condition to achieve a desired return. This paradox highlights the diversity of financial risks and their sources and underscores the need for business leaders to understand the financial risks inherent in their companies, no matter the size. Even companies with the most thoughtful, strategic business leaders encounter influences beyond their control — think macroeconomic shifts and political unrest — making identifying and preparing for the more foreseeable risks even more critical. This article identifies 10 common types of business risk and 15 ways to minimize them.

What Is Financial Risk for Companies/SMEs?

Financial risk is a broad term for situations that can lead to an adverse commercial impact, such as reduced profitability, loss of capital, strained cash flow and possibly business closure. Risk and reward tend to have a direct correlation — the greater the potential risk, the bigger the potential payoff. However, unlike high-stakes gamblers, business leaders have a fiduciary responsibility to protect their company and its constituents against overexposure to financial risk.

That list of undesirable outcomes can be especially concerning when one considers the significant number and variety of financial risks, including credit risk, market risk and fraud, to name a few. This is where risk management comes into the picture. Risk management is the preventative approach to mitigating financial risks. It's a combination of identifying, monitoring, controlling (where possible) and planning for potential risks to curtail their impact. Vigilance and preparation are key. Vigilance includes establishing and monitoring various internal and external indicators that can raise or lower risk. Preparation refers to developing strategies to avoid or lessen risks that carry the potential for losses, including, but not limited to, carrying various types of insurance policies.

Key Takeaways:

- Financial risk is unavoidable but can be mitigated with careful planning and the right tools.
- Different types of financial risk come from external sources, endemic factors and internal processes.
- High-quality, accurate data is fundamental to risk management.
- Examples 15 ways provide by Kristina Russo (2023) to avoid, reduce, transfer or accept financial risk.

Types of Financial Risks:

The first step in creating an effective financial risk mitigation plan is to identify the types of risks that could impact a business. Some types of risks are more pertinent than others, depending on the industry, the size of the company and other operational factors. Understanding the specific nuances of how these risks could impact a business allows for better planning and more effective mitigation. Ten common types of financial risk are:

Credit risk

Extending credit to customers is a standard practice in many industries, and it can be a useful way to expand a business's customer base and increase revenue. But extending credit also introduces a higher potential for uncollected sales. When customers don't pay, the seller's business loses revenue and has unrecouped costs for products or services delivered. And if a business has only a small number of customers, extending credit exposes it to even more credit risk if one of those customers experiences cash flow problems or goes out of business.

Market risk

Market risk for business refers to the external forces endemic to a company's specific industry. Evolving customer preferences, advancements in technology and other disruptors can cause an industry to morph and change, requiring businesses to adapt to survive. Consider the evolution in the recorded music industry from vinyl albums, to cassettes, to CDs, to digital streaming. Market risks are often out of management's control.

Competitive risk

The performance of other companies in a business's market creates competitive risk. Moves by existing competitors that provide comparable goods or services can upset a business's sales and cash inflows, for example, by changing prices, product features or distribution strategies. In addition, new competitors can emerge to vie for the same customers' attention and budgets by fulfilling their needs in different ways. A good example is how entertainment streaming services introduced competitive risk to movie theaters.

Liquidity risk

A company's liquidity refers to its ability to pay its current obligations using short-term assets, such as cash, accounts receivable and short-term investments. Liquidity can be thought of as a more specific and immediate form of cash flow. Liquidity risk is usually a matter of timing — ensuring that cash flow or the ability to convert assets to cash quickly is adequate to make timely payments on debt. Liquidity risk is higher when timing is out of sync or capital is locked up in long-term assets. An equipment-heavy construction business that must pay for building supplies in advance of cash collections would have higher liquidity risk than a cash-and-carry retail grocery store, for example.

Cash flow risk

Cash flow risk refers to the potential imbalance between all cash inflows and outflows. It involves the ability (or inability) to pay immediate and medium- and long-term obligations on a constant basis and is often impacted by systemic cash management policies. For example, periods of negative cash flow — when outflows are greater than inflows — can be overcome, but consistent negative cash flow is usually unsustainable. Consider the cash flow risk for a business that extends 120 days of credit to its customers but is subject to 60-day payment terms from its suppliers.

Growth risk

Business growth is typically viewed as a positive trend, but companies should be aware of potential risks. For one, overextension of capital to invest in expansion can cause liquidity issues. Second, stress on operational infrastructure can cause breakdowns in equipment, distribution interruptions or employee burnout, all of which can have fiscal consequences. Third, a business's reputation or its product's brand image can be impaired by poorly planned or executed growth, causing long-term financial problems. And last, even the best forecasts and projections for new business development contain estimates with varying degrees of accuracy.

Leverage risk

Leverage refers to the amount of borrowed capital a business uses to finance its operations or new investments. Leverage risk refers to the potential for the cost of these borrowings to become prohibitive or greater than the return on the underlying investment. Rising interest rates and lower-than-expected returns are variables that increase leverage risk. Another sort of leverage risk exists when a business maxes out its available credit and is unable to access additional funds in the event of emergencies or revenue downturns.

Global risk

In the interconnected global economy, businesses of all sizes encounter a level of global risk; it's not just reserved for large international conglomerates. Global risk stems from changes in government policy, exchange rates, foreign country economies, social unrest, cybersecurity threats, public health and many other factors. Bringing these issues closer to home, consider the global risk inherent in direct supply sourcing, such as shortages or price changes on parts imported from another country. Indirect supply chain issues are another example, such as the inability to purchase delivery trucks due to international chip shortages. Both examples ultimately have an impact on a business's sales and profitability.

Errors

Business leaders rely on accurate information to make well-informed decisions. In addition to running their everyday business, they need good data to identify and monitor business risks. Errors in any of this information increase the likelihood of sub-par decision-making and financial loss.

Fraud

Fraud is a real risk to most businesses. The potential for theft, embezzlement or cybersecurity breaches can come from both internal and external sources. Fraud causes direct financial loss, such as revenue skimming and asset loss, and can raise other risks, including reputation, compliance and legal risks with indirect financial consequences.

Understanding, monitoring, and mitigating financial risks are essential steps to maximize business success. These 15 approaches can help.

15 Ways to Mitigate Financial Risks by Kristina Russo

Source: Kristina Russo (2023), last retrieved on 20.11.20223 from: https://www.netsuite.com/portal/resource/articles/financial-management/minimize-financial-risks.shtml

15 Ways to Mitigate Financial Risk

By identifying and monitoring risks, a company is better positioned to mitigate their financial impact. The four approaches to mitigating financial risk are avoidance, reduction, transference and acceptance. Avoidance involves changing course to dodge the factors that cause the financial risk. Reduction takes the approach of managing through the risk but with measures to minimize its effects. Transference means off-loading or sharing some of the risk with other parties, such as business partners or insurance agencies. Finally, acceptance is the decision to move forward, accepting the potential consequences of the risk rather than taking action to mitigate or avoid it. Businesses may choose a particular approach based on the type of financial risk involved or they may opt to combine multiple approaches to address a risk. The 15 ways to mitigate financial risk listed here draw on all four approaches.

Carry insurance

Insurance is a way to transfer some financial risk to a third party. It comes in handy when paying for an unexpected loss, thereby preserving company capital. However, keep in mind that insurance policies carry premium costs, and while the proceeds of a claim can help finance recovery, they don't eliminate the risk or the disruption. There are dozens of business insurance policies covering all kinds of financial risks, including product liability, crime, commercial property claims, workers compensation, business interruption and cybercrime.

Evaluate efficiency

By maximizing operational efficiency a business can unlock cash flow that can be redirected to cover the impact of financial risk. Additionally, the process of continually evaluating aspects of a business can help identify potential business risks.

Maintain emergency funds

Establishing cash reserves is a way to prepare for the impact of financial risks. Along with insurance, emergency funds can help lessen financial losses and keep a business running. Emergency funds can be internally generated through positive cash flow or they can be in the form of an accessible line of credit. Preplanning is necessary in both cases.

Invest in quality assurance (QA)

Instituting strong QA measures to make sure that products and services meet desired quality standards is a way to reduce product-related financial risks. Checklists, checkpoints, sampling and supervision throughout the production process can help ensure better outcomes.

Diversify business investments

Diversification is a way to spread risk across multiple areas. When businesses hold investments in other companies through stocks or ownership stakes, selecting a variety of industries helps minimize the risk that investments all rise and fall together. Further, diversifying investments between equity and debt can help minimize volatility and risk. Similarly, diversifying a business's income streams, so as not to rely on a small number of products or customers, is another way to hedge financial loss and minimize risk.

Keep accounts receivable (AR) low

As AR balances age, collection becomes less likely. Uncollected AR results in lost revenue, reduced cash flow and lost profits, so it's important to stay on top of the balances by using an AR aging report, which tracks the payment status of a company's AR, or other similar tools. Additionally, AR vigilance can uncover customers that present credit risks so future sales terms can be adjusted to prevent future losses.

Read the fine print

Misunderstandings among commercial partners can cause all sorts of problems that can result in financial loss. Documenting agreements in writing helps reduce ambiguity and the likelihood of financial loss, especially when it comes to the finer details of an arrangement.

Reduce unneeded debt

Most businesses rely on loans from time to time to support gaps in cash flow and for long-term investments. However, it's important to manage leverage risk by keeping loan balances as low as possible to avoid excess borrowing costs, such as interest charges and bank fees, as well as heavy cash flow drains from inflated loan payments. Additionally, lower outstanding loan balances can maximize a company's available credit for emergencies and unforeseen challenges and opportunities.

Maintain quality records

Keeping quality records is fundamental to managing financial risk because it provides clean data for historical analysis and future visibility. It's also a primary way to avoid compliance risk. Businesses have many reporting requirements from lenders, government agencies, industry regulators and shareholders to prove they are meeting regulations and abiding by the law. Non-compliance results in direct penalties and indirect reputational risk. Sloppy record-keeping increases the risk of bad decision-making and non-compliance, making maintaining quality records table stakes.

Create a cash management strategy

Running out of cash is one of the most common reasons that businesses fail. Creating a cash management strategy helps reduce financial risks through planning and prevention. Forecasting cash inflows and outflows, monitoring AR and accounts payable balances, managing debt payments, keeping an eye on currency exchange and interest rates and staying close to market demand all play a part in developing a cash management strategy and can help lower risk.

Invest in employees

Employees can have a big impact on the success or failure of a business. This is especially evident in services industries, but it's also a factor that affects productivity in non-services industries. Because there is a direct correlation between the adequacy of employee training and business output, investing in employees reduces the risk of costly errors that can damage a company's reputation.

Outsource when it makes sense

Outsourcing certain functions is one way to mitigate certain financial risks by saving time and money. Hiring third-party specialists to handle certain parts of a business can bring cost savings, thanks to the service provider's economies of scale. Outsourcing can also save time because expertise is already in place. Financial risk is shared between the company and the service provider, and cost savings can be used to reduce risk in other areas of the business. Beware, though, that while outsourcing can reduce some financial risks, it may introduce others, so it's important to evaluate where it makes sense.

Focus on metrics for decisions

Consider the adage, "You can't manage what you don't measure." Using objective metrics helps lower financial risks by supporting impartial decision-making and helping leadership stay focused on tangible goals. Planning, measuring and using standardized, quality information can help keep a business on track and provide early warning if it's not. Impulsive or under-informed decisions tend to increase the level of risk.

Leverage financial technology

The right financial technology can bolster the other tactics for minimizing financial risk. Robust technology, such as cloud-based accounting software and integrated enterprise resource planning (ERP) systems, is essential for identifying and analyzing trends that might become risks — or opportunities. Financial technology is useful for planning and developing metrics and reduces the potential for manual errors in record-keeping.

Establish separation of duties

A strong internal control environment helps reduce the risk of errors and fraud. The internal control environment is a network of processes designed to catch anomalies before they happen (prevent controls) and to detect them if they do happen (detect controls). Segregation of duties is a primary control that works by ensuring that no single person has full control of a single transaction, usually by separating functions like recording, approving, paying and reconciling. Segregation of duties can be a challenge for small organizations but can be assisted by the right technology.

Conclusion / Summary

The present module description tries to cover the essence of entrepreneurship, entrepreneurial management, financial tools (sources of funding) assessment and evaluation needed for the purpose of their selection and the two most common approaches for the financial tools management. The information provided marks some of the main issues that fall into the regarded topics. The purpose of the modules is to provide a basis for all the remaining modules developed within the FAIRNESS Project.

Further reading

Resource name	Type	Link
Internal Rate of Return (IRR) Rule: Definition and Example	Video	https://www.investopedia.com/terms/i/irr.asp
Sources of Funding: Different ways to obtain financing	Website	https://corporatefinanceinstitute.com/resources/accounting/sources-of-funding/
Internal Rate of Return (IRR) Rule: Definition and Example	Website	https://www.investopedia.com/terms/i/irr.asp
Financial Management for Profit Maximization	Website	https://enterslice.com/learning/financial-management-for-profit-maximization/
15 Ways to Minimize Financial Risks in Business	Website	https://www.netsuite.com/portal/resource/articles/financial-management/minimize-financial-risks.shtml
Financial Analysis and Evaluation: Technical Guidance Note	Book, pdf file	https://www.adb.org/documents/financial-analysis-evaluation-guidance-note

Quiz

The correct answers are highlighted in bold:
Q1. Which of the following is not a feature of the entrepreneurship?

a) risk taking ;
b) creativity ;
c) **financial oriented ;**
d) innovations ;

Q2. Which of the following are financial tools (sources of funding) that can be used by the SMEs?

a) Private equity ;
b) Venture capital ;
c) Bank loans ;
d) Overdrafts ;
e) Grants ;
f) Crowdfunding ;
g) Private mortgages on housing or one 's own other private assets ;
h) Capital market bonds ;
i) Guarantee schemes ;
j) Forming of production cooperatives ;
k) Joint saving funds schemes ;

Q3. Which of the following methods are used for assessment and evaluation of the financial tools (sources of funding) for the development of the SMEs' business projects:

a) Calculating the Financial Net Present Value ;
b) Calculating the Financial Internal Rate of Return ;
c) Performing Risk and Sensitivity Analysis ;
d) Forecasting Incremental Business Project Net Cash Flows ;
e) Assessment of innovation ideas by the use of a complex evaluation coefficient ;
f) "Delfi" expert evaluation methods ;
c) "Ifo" expert evaluation methods ;

Q4. Which of the following are approaches for financial tools (sources of funding) managements?

a) Risk reduction ;
b) Risk aversion ;
c) Insurance and other means of risk sharing ;
d) Minimizing risks ;
e) Maximizing profit and wealth ;

Q5. The financial risk is a broad term for situations that can lead to an adverse commercial impact, such as reduced profitability, loss of capital, strained cash flow and possibly business closure. This statement is:

a) True ;
b) False ;

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