



# FINANCIAL ELEMENTS OF BUSINESS STABILITY IN COMPANIES

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**Abstract**: This article provides a financial indicators of business markets and the methods in the transition to international financial reporting standards and ways to overcome them.

**Keywords:** business, strategic resilience, costs, debts, Net Present Value, investment.

Business organizations exist within the context of larger market economies where conditions are always changing. For an organization to survive in the face of this constant change, analytical scientists recommend an organizational strategy of flexibility. They advocate a strategic resilience, which is achievable when managers anticipate and adjust to changes that threaten a company's core competencies. However, their suggestions for developing strategic resilience contain little guidance for incorporating financial decisions in the organization's strategic deliberations. An initial step for financial analysis is the quantitative evaluation of a firm's investment opportunities. But special care is required here. The traditional Net Present Value (NPV) computations, first made popular by Dean, assume that once an investment is made, a manager cannot revise the initial commitment of resources in order to change future cash flows. These methods are still taught today, but they ignore flexibility. Many investments are not passive investments that are unchangeable once committed. Managers can and do act after initial investment commitments have been made to adjust the size and nature of cash flows when past assumptions about future conditions prove incorrect. To reflect the market value of such potential adjustments, Real Option Theory moves away from NPV's assumption of a passive manager who no longer acts once an investment decision is made, to that of active management that permits managers to enact changes in resource commitments after initial investment is made. In this new view, total NPV of an investment opportunity is seen as a sum of two components: 1. The NPV with no revisions, plus 2. The NPV that is associated with possible revisions in commitments. Real Option Theory offers financial

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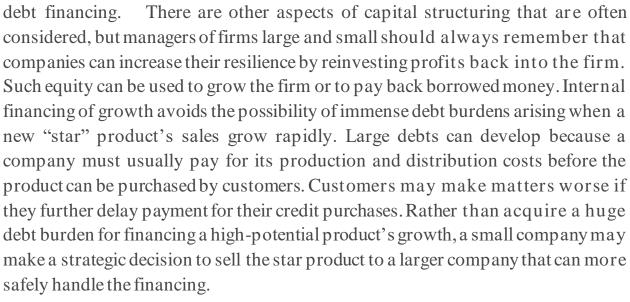
Strategic resilience comes at a cost, and managers may quickly find that its development places constraints on profits. Much like with other core competencies or "competitive advantages" of a company, resilience requires an investment to

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develop and maintain. Core competencies lead to a company's success in its markets, and benchmarking against the competencies of competitors may mandate larger investments just to remain competitive. Even when financial analyses indicate that investments into certain core competencies are not fiscally prudent, managers may choose to make these investments because of strategic goals, such as staying at the forefront of some relevant technology. Every company needs to ask itself what level of financial resources should be held in reserve? Different levels will be appropriate for different companies, and resilience may affect profits in different ways. The costs of developing resilience may reduce profits; however, resilience contributes to continued company survival. Choosing a specific level of a company's strategic resilience requires periodic judgments that balance its value against its costs. Such judgments are further complicated by situations where resilience may actually increase profits by allowing a company to seize unexpected opportunities. When performing financial analyses, managers need to consider how all of the company's competencies can assist in their efforts. For example, a company may have a "captive buyer" for whom the company is the only possible source for its vital inputs. This kind of company could potentially pass cost increases along to its customers, thereby using its "marketing competency" to maintain financial resilience. Alternatively, for a company that cannot pass its cost increases along to customers, hedging may be desirable. Hedging may reduce the future profits of a company, but it can allow this company to offer stable prices to customers at a profit for the long-term. Some companies have customers that expect stable prices, while others have customers that accept price fluctuations. For example, a coffee shop may hedge its purchases of coffee because its patrons expect to pay customary prices for standard sized cups. Conversely, a gasoline station operator might not hedge gasoline purchases because customers are used to paying fluctuating gasoline prices. The key is to leverage your strengths against economic uncertainty. Each company will need to assess its core competencies and strategize as to how they can be best utilized in developing the ultimate core competency of resilience.

As a company selects investments, decisions regarding financing needs and capital structure can affect company resilience, and therefore require strategic consideration. For example, resilience will decrease as financial leverage increases, because large debts impose cash-flow burdens that reduce flexibility. This is especially troublesome for small businesses because of their tendency to rely on

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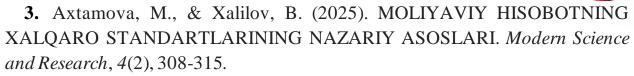


In conclusion, any organization that possesses a core competency can succeed during times of economic prosperity. Only those that are resilient can survive economic change. Flexible organizations are able to adjust to economic fluctuations while keeping these core competencies intact. This flexibility must extend to the company's capital investment policy. Managers who employ Real Option Theory can evaluate capital investment opportunities in terms of their flexibility, favoring capital commitments that do not put the future of the organization in jeopardy. This approach, followed by the aforementioned steps, will help optimize a company's resilience through its financial decision-making processes. Traditional capital budgeting methods will not help managers to do this work.

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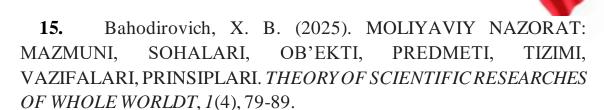
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