Research on Financial Risk Identification and Prevention and Control from the Perspective of Cash Flow

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Abstract: Cash flow usually runs through the whole process of enterprise production and operation, and plays a key role in the healthy and stable development of enterprises. Firstly, this paper briefly analyzes the financial risk identification of cash flow, and then explores the financial risk identification and prevention and control measures based on cash flow for reference.

1. Introduction

For enterprises, financial risks generally hide inside the company and in the market. Like enterprise capital allocation, daily business, operation and management, enterprise investment, etc. when involving a corresponding amount of funds, they will also face risk problems at the same time. It can be seen that there is an inevitable connection between cash flow and financial risks. Therefore, for enterprises, financial risks must be identified as soon as possible and targeted prevention and control measures must be taken to ensure the stable operation of funds [1].

2. Identification of Financial Risk from the Perspective of Cash Flow

2.1 Identify Financial Risks in Investment Activities

In the process of carrying out investment activities, enterprises should first understand the types of investment projects, then learn the characteristics of projects, and finally judge the impact of projects on enterprises. If the recovery of investment income is slow, the investment time is long and the investment amount is large, the enterprise will undoubtedly face certain risks. At the same time, in order to expand the production scale, individual enterprises often blindly carry out diversified investment activities, and due to the lack of evaluation of their own actual situation before investment, it will eventually lead to decision-making mistakes, not conducive to the long-term and stable development of the enterprise. Therefore, in the process of carrying out investment activities in the future, enterprises must strengthen financial risk identification to avoid affecting their own stable development [2].

2.2 Identify Financial Risks in Business Activities

In the business activities of enterprises, there are often various financial risks, which generally come from the following two aspects. First, in order to obtain higher sales performance, many enterprises often take the way of credit sales for those customers who can’t pay for the goods at the first time in the process of product sales. Although this method can bring corresponding book profits to the enterprise, with the continuous increase of credit sales, the enterprise will have a high probability of facing the risk of bad debts, and the book profits are difficult to be converted into real cash. Therefore, from a certain point of view, it can’t bring benefits to the enterprise, but also increase the financial risk intangibly. Second, enterprises will also face risks in the procurement process. For example, individual enterprises fail to formulate a clear procurement plan before purchasing goods, resulting in a large difference between the purchased goods and the actual demand, and even a large backlog of inventory. This situation will also lead to the occupation of enterprise funds and can’t be realized in a short time. At the same time, in the process of purchasing commodities, many enterprises will also face serious capital losses due to the asymmetry between the product information obtained and the merchant information, or the problems of dishonesty and low product quality. Therefore, enterprises should also strengthen the identification of financial risks in the process of carrying out business activities [3].

2.3 Identify Financial Risks in Financing Activities

The common financing methods of enterprises mainly include equity financing and debt financing. In the process of equity investment, although there is no need to repay the interest and principal due, in order to avoid the impact on the reinvestment and social reputation of enterprises and ensure that enterprises can obtain more equity investment in the future, enterprises must have sufficient funds to pay dividends. In the process of debt financing, enterprises must ensure that they have enough funds to pay interest and repay loans in future production and operation activities. If they do not have such qualifications and conditions, they are easy to get into trouble and even affect their own survival and development. Therefore, enterprises should also be good at identifying financial risks in financing activities to maintain their own healthy and stable development [4].

3. Financial Risk Identification and Control Based on Cash Flow

3.1 Improve the Financial Risk Identification System

3.1.1 Solvency Indicators

At this stage, many enterprises in China operate through borrowing, but for a long time, it is easy for enterprises to face huge debt repayment pressure. At the same time, because enterprises maintain daily business activities through borrowing, it is not conducive to the long-term development of enterprises. The cash flow repayment index can reflect the cash flow status of the enterprise. The cash flow repayment index mainly includes the following two aspects:

First, annual net operating cash flow / year-end current liabilities = cash current liabilities ratio. Through this indicator, we can understand the real solvency of the enterprise in an all-round and three-dimensional way. The larger the indicator, the more stable the business situation of the enterprise. At the same time, it can also bring more cash flow to the enterprise, and its own solvency will be improved. If the cash flow coverage ratio of an enterprise is relatively low, it often means that the enterprise’s operating activities are insufficient, and the loan also requires the enterprise to repay with cash. If the enterprise can’t reserve enough cash, it will face greater financial risks and even threaten its own stable development. Therefore, enterprises must improve feasible measures to improve the cash flow of operating activities to reduce the probability of various financial risks. Second, net cash flow / amount of interest payable in the same period = cash interest payment rate. This indicator is large, which means that the enterprise has high interest payment ability and strong business stability. If this indicator is small, it means that the enterprise does not have good interest payment ability. In the long run, the enterprise will also face certain financial risks, not conducive to the healthy and stable development of enterprises.

3.1.2 Profitability Indicators

For cash flow, the profitability index can reflect the cash profitability of the enterprise and the cash profitability of the enterprise. If the cash profitability of the enterprise is good, it means that the enterprise can obtain higher economic benefits, and the corresponding financial risk probability will be reduced. However, if the cash profitability of the enterprise is poor, it means that the cash creation ability of the enterprise is poor and is likely to face greater financial risks in future development [5].

Net cash flow / average net assets = cash return on net assets. Through this indicator, the profitability of the net assets of the enterprise can be reflected. The larger the indicator means the stronger the profitability of the enterprise, and the smaller the indicator means the worse the profitability of the enterprise. At the same time, it also means that the enterprise will face greater financial risks in its future development. Net flow / net profit of operating activities = cash income ratio. If the index value is above 1, it means that the enterprise has good profitability. If the ratio is below 1, it means that the enterprise has poor profitability. Even if it is profitable this year, it has a high probability of financial risk in the future.

3.2 Improve the Cash Flow Financial Risk Prevention and Control Measures

3.2.1 Strengthen Cash Flow Management

In order to achieve long-term and stable development, enterprises should not only ensure good book profits, but also have sufficient and sustainable cash flow. In the business activities of enterprises, cash flow is very important. Therefore, enterprises must strengthen the management of cash flow. In the production link, the cost of raw materials must be strictly controlled. In the sales link, for credit customers, it is necessary to timely urge them to repay, so as to ensure the normal flow of funds and avoid bad debt problems. In the procurement link, the procurement personnel must formulate a clear plan before formal procurement, and make full use of the credit period, so that the payment period of accounts payable can be extended to maximize the role and value of cash in a limited time. In addition, enterprises should also ensure the stability of cash flow. Too much or too little cash is not the best cash flow state. Enterprises should strive to maintain the balance between cash outflow and inflow, which is conducive to the sustainable and stable development of enterprises. In order to achieve the above objectives, enterprises must properly do a good job in cash flow budget, make reasonable arrangements for expenditure in combination with the total amount of cash they currently have, strengthen cash flow control, pay close attention to the specific flow direction of each fund, avoid excessive non production investment and consumer expenditure, and eliminate the problem of capital waste [6].

3.2.2 Strengthen the Management of Enterprise Financing, Investment and Business Activities

In the process of enterprise development, business activities are one of the main activities and are closely related to cash flow. Therefore, in the business activities of enterprises, it is necessary to strengthen the identification and control of financial risks. In practice, enterprises can formulate financial management plans in combination with their own capital status and business status, so as to ensure the reasonable expenditure and distribution of funds, ensure that the enterprise has sufficient funds to maintain daily production and operation, and the remaining funds can be used for investment projects, so as to improve the application efficiency of limited funds and create higher economic benefits for the enterprise. In the investment activities of enterprises, it is also necessary to strengthen the identification of financial risks. Before investing, enterprises must understand the characteristics of the project, including the rate of return, payback period, risk size and so on, so as to reduce the probability of financial risks. In the fund-raising activities, the enterprise shall reasonably arrange the fund-raising amount and time in combination with its own operating conditions. If the investment amount is large and the enterprise is unable to repay the interest and loan within the specified period, it will affect the social reputation of the enterprise. If the fund-raising amount is too small, it will be difficult to meet the development needs of the enterprise and will also hinder the development and progress of the enterprise. Therefore, in the process of financing, enterprises must combine their own actual situation, give play to the value and role of financial leverage, and select the repayment period consistent with their own actual situation, so that enterprises can have sufficient funds to repay interest and loans within the specified period [7].

4. Conclusion

To sum up, various financial risks often occur in enterprise investment, financing and production and operation activities. From the perspective of cash flow, enterprises must strengthen the identification and prevention and control of financial risks, establish a perfect financial risk identification system and take feasible financial risk prevention and control measures. Only in this way can reduce the occurrence probability of enterprise financial risk and promote the long-term and stable development of enterprises.

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