The Role of Business Restructuring in Financial Performance Enhancement

Inese Mavlutova

Abstract: **-** In today's dynamic environment, it is often essential for businesses to undertake appropriate restructuring measures that would enable them to capitalize on their strengths. Restructuring is one of the most popular scenarios for company's development. Motives of restructuring vary significantly; still the main target is company's market value increase and financial performance enhancement in a result of implementing company's restructuring program. The author examined conceptual basics of the company's financial strategy, study restructuring as one of common methods of company's development under inconsistent economical conditions, examined the methods of evaluating the company's market value and financial analysis used during restructuring process.

Key words: - Business Restructuring, Company's market value, Financial performance, Risk, Financial indicators, Multiple discriminated analysis, CAPM.

I. INTRODUCTION

During recession and after it a majority of companies experience financial difficulties, and one of the possibilities of managing them lies in the restructuring of the company.

Due to impact of inconsistent economical environment and processes of globalization life cycle of companies has shrunken and business has become more dynamic, which has encouraged processes of restructuring companies. Motives of restructuring vary significantly, still the target is one – increase of company's market value and raise of efficiency in a result of implementing company's restructuring program. Restructuring is a composite of numerous interrelated activities – from diagnostics to restructuring organizational structures and business processes based on modern management approaches.

As a result of research conclusion has been made that restructuring is a process aimed at maximization of company's market value by implementing methods of improving company's activity. During the process of enacting successful financial strategy the following targets are gained by restructuring the company:

- increase of company's equity value as an obligatory condition to increase the competitiveness,
- company's financial position is improving due to strengthening of its solvency, liquidity, financial stability and profitability,

The objective of the research – to justify attractiveness of restructuring used to improve the company's financial performance and position, based on study of methods of modern financial analysis and management.

Generally accepted quantitative and qualitative methods of research in management science were used, including induction and deduction, analysis and synthesis, logically constructive and statistical methods, economic mathematical simulation, description and display methods of numeral information.

II. BUSINESS RESTRUCTURING AS A TOOL OF FINANCIAL STRATEGY

It is examined during research that in scientific literature concept about strategy as a composite of conditions to make management decisions about future activities of the company formed in 20th century's early eighties. Enactment of strategically significant decisions is at first related to attracting monetary resources, respectively, to the quality of financial management in a company [1]. The main component of financial management on the other hand is financial strategy, which includes establishment of sustainable system of financial activity's targets and indicators, as well as determining priority tasks for present perspective. In general financial strategy is defined as business policy in the matter of main directions of financial development.

Aspects of financial strategy are described in publications of *Van Horne J.*, *Vachowicz J.*[2], *Brigham E.*, *Gapenski I.*[3].

Company's financial strategy is developed with consideration of different fixed conditions or their predictable development. Since they are not taken into consideration often, especially in long-term perspective, it is always possible that set targets and planned strategic result will not be accomplished. Financial strategy's potential deviation from the objective is considered as consequences emerging from financial risk.

The matter of the complicity of activities related to preventing the difficulties is dependent on the complicity of the problems – starting with technical insolvency and concluding with bankruptcy.

During the *stage of owner's crisis* financial position of the company worsens, which initially does not influence the payments to creditors. The criterion chosen is the limitation of interests of the owner, respectively, the real loss of owners investing.

Theoretical ground of offered criterion and numeral measurement is completely possible, despite of apparent abstractness. For owners the company is an object of investing financial resources, allowing to increase the value of the resources invested. In order to compare the effectiveness of investments, alternative investments with the same risk level can be used as the ground. Therefore, to determine the direct loss to owners, present market value and present initial investment value of the equity capital should be compared, considering that they will be used as alternative investments with the same risk level.

Thereby the following inequality can be used as the criterion of the first stage which is the owner's crisis:

$$\frac{TV_{pk} + D}{TV_{pam}} \langle 1, \text{ where} \qquad (1)$$

TV_{pk} – company's market value;

D – owner's dividends;

TV_{pam} – present initial investment value of the equity capital with the possible alternative use of the resources invested with the same risk and liquidity level.

The insolvency of the company can be described both as episodic and chronic. In the latter case a huge possibility of bankruptcy may arise, which is understood as legally admitted or announced by debtor as inability to satisfy creditor's financial demands in full and/or inability to meet their obligatory payment.

Therefore to avoid situations of crisis, company's financial position has to be evaluated in a good time, so in case of instable situation composite of actions can be enacted in order to recover it. One of the key elements of the activity's system is ***restructuring of the company*** [4].

Together with integration in European Union the competition became more intense in several areas of entrepreneurship in Baltic States, so new requests for entrepreneurship methods were brought forward. Restructuring as a method of increasing market value of the company is common in industrial countries [5]. However it is characteristic for Baltic market that bulk of small and medium size companies often uses irrational methods of financing. Therefore managing structure of financial sources and financial flow is irrational in these companies.

Considering the company as a complicated system, dependent on external and internal factors, ***company's restructuring*** is defined as changing the structure or as changing the business units. Considering the impact of both external and internal factors, restructuring includes improvement of company's management systems, financial, economic and strategic activities, marketing systems, personnel management, quality management and innovation management.

Low efficiency of the company's activity after the recession can be considered as the main cause of restructuring, which is reflected by poor financial indicators, scarcity of current assets, huge debtor and creditor debt amount and arriving at situation of crisis.

Matters of company's restructuring and their importance in the viability of companies in transition economies are studied by *Dockery E., Herbert W.E.*[6]*, Crum R.L., Goldberg I.*[7] In general the scientists consider that the optimal speed of restructuring is dependent on desires of employees, culture barriers and existence of competitors desiring for addition of the company. Therefore the optimal speed of restructuring differs in every particular case.

With following to strategic and tactical targets, majority of the ***motives of restructuring company*** can be classified in following groups:

- Decreasing the outflow of company's resources (mainly the money);
- Increase or stabilization of company's inflow of resources;
- Motives leaving out the movement of resources.

By summarizing the motives of restructuring, a conclusion can be made that the managers and owners traditionally enact two targets: increase of company's competitiveness and further increase of company's value. Depending on targets and company's strategy one of the types of restructuring is chosen – operative or strategic.

Table I Structure of main restructuring motives

Decreasing the outflow of resources	Increasing the inflow of resources	Motives leaving out the movement of resources
Effect of production scale Cheapest information Centralization of functions Avoiding duplication Rising effectiveness Combining scientific studies Decreasing prices of financial sources Decreasing budgetary payments	Increasing solvency Diversification Motive of large enterprise Biggest transactions Mutually supplementing resources Availability of information	Difference between market and book value Motives of first level management Protection from being taken over

International practice and skills of enacting restructuring in Baltic countries testifies that ***restructuring*** is one of the most complicated tasks of management. Restructuring is not simultaneous changes in resource and capital structure or in the economic activity in general. During this process several obligatory restrictions should be followed as well as the specific character of the company. Therefore the restructuring process can be enacted only when the targets are clarified, the concept of restructuring is justified and all the stages and methods are comprehended.

Together with more detailed examination it is noted that the term "***company's restructuring***" does not refer only to the activities changing the organizational structure of the company. It can mark all the complex of problems encountered by Baltic companies. It is clear that the restructuring targets are set by the strategy, while financial resources provides the ground of enacting it and defines the effect of enactment. That means that for justifying the targets of restructuring use of integrated financial strategy's definition would be the most appropriate, and to choose the type of restructuring by evaluating its results and effectiveness as well.

The author has concluded that an important part of *company's restructuring* concept is the classification of the types, because restructuring means crucial change of company's organizational, asset and capital structure. There are several approaches of enacting restructuring. The author prefers the following ***types of restructuring***: mergers of companies, acquisitions of companies, forming strategic alliances, restructuring of property, activities to eliminate financial difficulties. All types of restructuring are related to company's financial strategy.

No matter how formal the motives of company's restructuring are, its real objective is gaining additional effect (effect of synergy).

During examination of several Latvian and foreign expert conclusions, the author has concluded that during the process of restructuring the most appropriate concept for evaluating company's market value is the income concept which includes two techniques: capitalization of income and discounting the future cash flow [8].

Capitalization of income technique is the most appropriate for evaluating companies with the future activity matching to their former profile of activity, assuming that the speed of growth will be standard.

Capitalization of income technique refers to companies planning steady increase of income, thereby the possibilities of the use of it to evaluate company's market value during restructuring process is limited. Considering that company's restructuring prescribes that the economical activity of the company will be improved considerably by synergy or other activities, for evaluation of the market value former speed of growth is not considered. Different development scenario is worked out.

The technique of discounting the future cash flow is applied to companies with a possible difference between future and existing activity. The mostly used method of the technique is discounting the future cash flow. Technique of discounting the future cash flow defines company's capital value by its ability to make profits in the future – the company's produced cash flow in the future is discounted to determine its present value.

There are two main cash attraction sources for business purchasing transactions in the finance theory: equity and borrowed capital [9].

During the research it was clarified that a model exists which defines approximate costs of borrowed capital, using bond prices as a bench-mark. *The price of the borrowed capital* can be calculated with using the following formula (2):

The price of the borrowed capital = Income from the bonds + Premium of company's credit risk (2)

The equity price can be calculated by using two main methods acknowledged by world known financiers:

I. Dividend discounting model.
II. Capital asset pricing model or ***CAPM*** [10].

The most important indicator of company's economical activity is the increase of equity value; thereby the company's restructuring traditionally is performed in this direction. Company's market value indicator as a restructuring criterion is not chosen randomly. As a result the owners are less interested in the sphere of the activity, technology used, parameters and characteristics of the goods and services produced and the market. Investment efficiency criterion is constant growth of investment value, which defines the increase of the owner's personal prosperity and a steady development of the company as well.

Company's market value is defined during evaluating business (operating company). By author, from the three traditional approaches the most precise are cash flow discounting method and income method to reflecting the company's internal value. It is determined by the high correlation of the cash flow, indicating the company's market value and the cash flow indicator including all the decisions related to economical, investment and financial activity.

The model of cash flow discounting method can be expressed in a formula:

$$V = \sum_{t=1}^{T} \frac{CF_n}{(1+r)^{(t-0,5)}} + \frac{V_{atl}}{(1+r)^T} \quad (3)$$

where

t – year for predictions,
T – calculating horizon,
r – discount rate,
CF_n – cash flow during period n,
V_{atl} – terminal value outside the calculating period for predictions.

Company's value indicator calculated with the use of ***cash flow discounting method*** includes the achieved present value of the cash flow during stage of stabilization of the company (within predictable calculating period) and the discounted value of the cash flow outside the predictable calculating period. The cash flow is defined on the basis of net profit and depreciation deduction which is in hand of the company as target financial resources.

III. BUSINESS RESTRUCTURING AS A METHOD OF IMPROVING THE MANAGEMENT RESULTS

Traditional target of the restructuring is maximization of the company's market value. Development concept is managed by a defined methodology. In the first stage the company's market value before the restructuring must be calculated by the use of cash flow discounting method or income method. Afterwards different alternatives of restructuring economic, investment and financial activities have to be developed. Within the factors of economic activity decision analysis about the nomenclature of goods and services, price formation, cost effectiveness, markets, advertising sphere, sales and post sale services has to be performed.

The following can be attributed to investment factors defining the direction of the value: management of current assets and optimization of labor capital. Supplies, debtor and creditor liabilities, increase in capacity, planning the capital investments and selling the assets have to be analyzed [11]. Equity value, proportion of equity and borrowed capital, structure of the capital are included as financial factors.

The developed activities were inspected with the use of ***company's evaluation model***. One of the criterions of choosing alternatives is increasing company's market value. The strategy aimed at increasing the company's market value is considered as a ground for restructuring alternative consideration described subsequently.

Restructuring strategies have to be reviewed "from the easiest to more complicated", respectively, from the alternatives anticipating minimal capital investment and external funding to the investment projects renewing the technologies of goods and services provided. However it is important to consider that many companies experience the situation where the most important thing is to meet the creditor demands. It often does not conform to the traditional target of restructuring – maximization of company's market value, because the strategy is related to high level of risks.

The author has found a necessity for development of methodology of the restructuring model. It is based on a

principle of improving the financial position of companies, which is linked to the needs of the company, its survival and successful development.

In order to solve the problems a model (Fig. 1) is offered by author which contains a row of sequential activities with a feedback which enables correction of targets and tasks in order to stabilize and improve the financial position of the company. The starting point of the model development is defining company's restructuring motivation and mission.

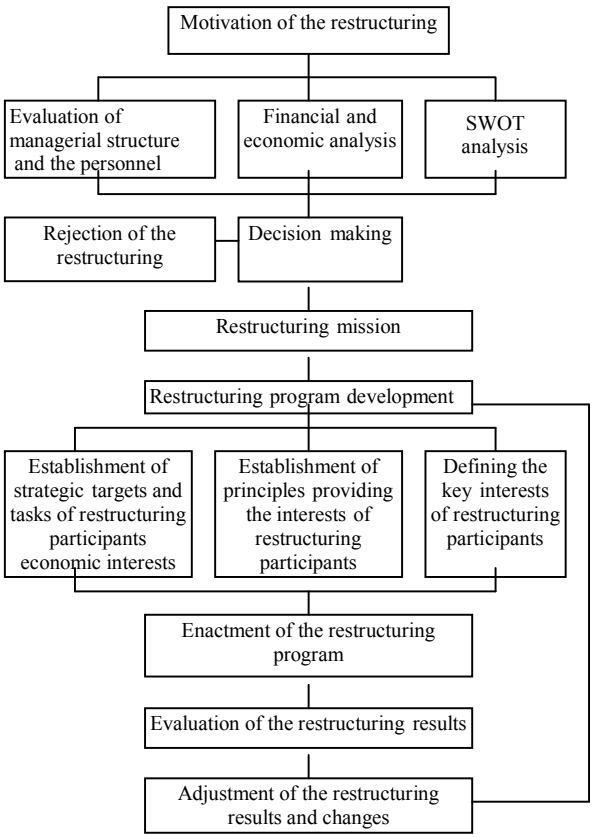

Fig. 1 Algorithm of establishing the company's restructuring model

The performed researches enable to make conclusion that the company's restructuring is related to high risk level.
The most significant risks with a negative impact on enacting the restructuring program are:

- wrong choice of restructuring method;
- prematurely evaluated restructuring results;
- insufficient qualification of the management;
- wrong evaluation of resources necessary to performing restructuring;
- insufficient motivation of the restructuring participants;
- emergence of negative social consequences during enactment of restructuring;
- inadequate legal coverage of the restructuring project.

By studying the process of forming cash flow during the enactment of restructuring program, it becomes clear that the discount rate is a indicator of capital investment efficiency when investing capital in the company, making decisions about purchasing the future income today and considering the acquirement risk. In order to make the right decision about investing capital in the company with analogical cash flows, the discount rate anticipates the risks related to capital investment in this kind of entrepreneurship.

Analysis of the failures is made and the factors are identified: increase of labor fluctuation, absence of strategy, insufficient evaluation of the costs, willful non-objective evaluation, Scarcity of the necessary control, slow decision making and uncertainty of the competition limits, barriers of cultural differences and scarcity of managerial experience [12].

IV. FINANCIAL ANALYSIS FOR COMPANY' S DIAGNOSTICS

Association of Financial Analysts offers the main listing of financial indicators in order to evaluate the company's financial position [13]. Financial ratios shown in the Table II are offered for the strategic financial analysis.

Table II The main financial indicators used in strategic financial analysis

Indicators	Calculation
Return on equity, ROE	Net profit x 100 / Equity
Pretax margin, ROS	Earnings before taxes x 100 / Net turnover
Stock turnover	Net turnover / Stocks
Debtor turnover	Net turnover / Debtors
Days of sales outstanding, DSO	Debtors x 360 / Net turnover
Turnover Ratio of long-term investments	Net turnover / Long-term investments
Total liquidity ratio	Current assets / Short term debts
Quick Ratio	Cash + Short term capital inv +Debtors / Short term liabilities
Cash ratio	Cash / Short term liabilities
Debt–to–capital, DR	Liabilities . / Liabilities + Equity
Interest Coverage Ratio, ISCR	Earnings before inter. and taxes / Interest

Of course, the company's economic activity's analyzes methodology does not give the answer to all the questions set by analysts and investors about defining the market value of the company analyzed, while it gives the concept of the key realities of the examined company – it makes possible to correctly compare the results gained by the company with the predictable future evaluation.

In order to evaluate the influence of the factors that reflect the financial performance of the company, usually a modified ***Dupont*** model is used:

$$K = \frac{P^a}{P} \times \frac{P}{NA} \times \frac{NA}{BK} \times \frac{BK}{PK} \times 100\ \% \quad (4),$$ where

$\frac{P^a}{P}$ – describes the company's dividend policy which is shown as a ratio of dividends paid versus the profit reinvested in the development of production;

$\frac{P}{NA}$ – describes the profitability of the sold product (services);

$\frac{NA}{BK}$ – describes the return of resources;

$\frac{BK}{PK}$ – financial leverage, which describes the ratio of balance sheet amount versus the equity.

This model reflects the influence on the ratios of economic stability by both, the company's economic activity (second and third factor), and its financial activity (first and fourth factor). Furthermore, the company has the possibility to use certain economic levers in order to influence the increase of such coefficient – decreasing the amount of dividends to be paid, increasing the return of resources, increasing the profitability of the product and services, seeking possibilities to receive favorable credits and loans.

The proposed model may be extended by adding important indicators which describe the company's financial position:

- sufficiency of current assets,
- liquidity,
- turnover of current assets,
- short-term liabilities on equity.

The extended model of factors for determining the economic growth indicator of company is the following:

$$K = \frac{P^a}{P} \times \frac{P}{NA} \times \frac{NA}{WK} \times \frac{WK}{AL} \times \frac{AL}{IK} \times \frac{IK}{BK} \times \frac{BK}{PK} \times 100\ \%$$

(5), where

$\frac{P^a}{P}$ – part of profit which is reinvested in development and which is determined as a ratio of the profit allocated to development of the company versus the net profit;

$\frac{P}{NA}$ – profitability of the sold product (labor, services), determined as ratio of net profit versus net returns;

$\frac{NA}{WK}$ – working capital returns, determines as ratio of net returns (of products, labor, services) versus the amount of own current assets;

$\frac{WK}{AL}$ – working capital sufficiency, determined as ratio of own current assets versus the all current assets;

$\frac{AL}{IK}$ – current liquidity ratio, determined as ratio of current assets versus short-term liabilities;

$\frac{IK}{BK}$ – the share of short-term liabilities in the company's capital, determined as ratio of the short-term liabilities versus the balance sheet total ;

$\frac{BK}{PK}$ – financial leverage, determined as ratio of the balance total versus the equity.

The analysis of dynamics factors of the economic growth ratios is performed based on the data of the company's annual report. The application of this ratios semi-factor model in substance means forecasting the company's development rate, taking into consideration the bankruptcy risk.

Bankruptcy is a regular consequence of unsuccessful business management. It is not suddenly and unreasonably that a business ends up bankrupt; thereby it is possible to prognosticate, foresee and prevent such an outcome. The possibility of bankruptcy can be determined – with a high degree of probability – by existing methods of forecasting,

Financial managers may face a task to identify the most appropriate method for prognostication of eventual bankruptcy in particular circumstances.

There are three ways in the contemporary practice of prognostication of the financial standing with regard to an eventual bankruptcy:

- applying a system of criteria and indicators for diagnostics of possible bankruptcy;
- calculation of the universal solvency index;
- prognosticative calculation of indicators characterizing structural condition of balance.

Nowadays it is possible and also necessary to apply a system of criteria for diagnostics of possible bankruptcy, though it is not completely faultless. As the criteria have various degrees of importance, it is always problematic to determine how and which criteria are enough to speak of an eventual bankruptcy. In order to avoid subjectivity in evaluation of a business it is a matter of necessity mainly to base upon experience of auditing and apply the following system of criteria as a preliminary signal system for more detailed case analysis.

Two–stage system of criteria and signs for prognosticating the probability of bankruptcy according to recommendations from the Committee for Audit Practice (Great Britain) is shown below:

Table III Two- stage system of criteria for prognostication of company's bankruptcy

The following indicates and criteria suggest possible financial problems and possibility of bankruptcy in the near future.	Serious, recurring losses in basic activity (steady fall in volume of production; declining volume of sales; continuously negative profitability) Regular overdue payments to creditors and regular overdue payments of debts by debtors Excessive use of short–term credit resources for long–term financing needs Low liquidity indicators Increase in proportion of borrowed capital Shortage of own working capital Continuous increase of capital turnover period Excessive stocks of raw materials and finished products Wrong reinvestment and dividends policy Regular default of repayment of loans and payments of interests Worsening relations with credit institutions Applying new sources of financing on disadvantageous terms Exploitation of physically and morally outdated equipment Unfavorable changes in the portfolio of orders Fall in market value of a company's shares Declining production potential
Unfavorable influence of the following indicators is not necessarily a foundation to consider the existing financial position to be critical, but it may as well deteriorate if appropriate steps are not taken in the future	Low degree of diversification of a business activity (excessive dependence of a business upon a certain project, sort of equipment, sort of assets, raw materials or sales market) Loss of the most important contractors Underestimation of the necessity to renew equipment and technology Forced idle time and breaches in the rhythmical pace of the technological production process Overestimated efficiency of new projects Implication in trials without predictable outcome for a business Loss of competent managerial staff Ineffective long–term agreements Shortage of investments High–level political risk

Appearance of one or another criterion or a group of criteria does not provide a base for the management to make the ultimate decision. Analysts always have tried to foresee bankruptcy on the ground of the numerical ratios or a generalized indicator. In the sixties of the 20th century, William Beaver made a first attempt to systemize ratios reflecting probability for bankruptcies of companies. He identified the ratios dynamics of which showed signs of bankruptcy. By analyzing the tendency of changes in financial indicators and applying the scale of critical values, the company in question could be related to a certain group of risk.

Further development of adaptation of the financial indicators to prognostication of bankruptcy ended in what became a working–out of unified, generalized indicator. The most common is a pattern developed by E. I. Altman in 1968. Solvency index Z can be calculated by ***Multiple Discriminated Analysis (MDA)*** in the following way [14]:

The pattern of five factors by E. Altman:

$$\mathbf{Z = 1,2\ K_1 + 1,4\ K_2 + 3,3\ K_3 + 0,6\ K_4 + 1,0\ K_5} \quad (6),$$

where

$\mathbf{K_1}$ – own current assets / total assets;

$\mathbf{K_2}$ – retained earnings / total assets;

$\mathbf{K_3}$ – earnings before interests and taxes (EBIT) / total assets;

$\mathbf{K_4}$ – share capital at market value / liabilities;

$\mathbf{K_5}$ – net turnover / total assets.

Critical value – 2, 675.

The prognostication indicating probability of bankruptcy depends upon quantity of **Z**:

- under 1, 8 – extremely high;
- from 1, 8 to 2, 7 – high;
- from 2, 8 to 2, 9 – possible;
- more than 3, 0 – very low.

In order to work out the pattern Altman studied a large number of companies in US, taking into account 22 financial ratios relating to the evaluation of eventual bankruptcy. In the course of the research five ratios of the greatest importance in forecasting the possibility of bankruptcy were made separate. They were given a weight, with parameters evaluated on the ground of statistical data processing for chosen companies. The pattern made it possible to forecast bankruptcy with the precision of 95 %.

The pattern, however, does not take into consideration specifics of other countries, specifics of different industries, and the fact that its main target is the range of major public stock corporations quoting shares in stock market makes it difficult to apply the pattern in other circumstances. Thus a version of the pattern was developed containing indices based only upon data of financial statements.

Version of the pattern of Altman:

$$\mathbf{Z = 0,72\ K_1 + 0,85\ K_2 + 3,1\ K_3 + 0,42\ K_4 + 1,0\ K_5} \quad (7),$$

where

$\mathbf{K_1}$ - net working capital / total assets;

$\mathbf{K_2}$ - net profit / total assets;

$\mathbf{K_3}$ - EBIT / total assets;

$\mathbf{K_4}$ - equity / liabilities (borrowed capital);

$\mathbf{K_5}$ - net turnover / total assets.

The prognostication indicating probability of bankruptcy depends upon quantity of **Z**:

Z < 1, 20 – high probability of insolvency;

1, 20 < **Z** < 2, 90 – uncertain position;

2, 90 < **Z** – insolvency is not prospective.

At the *Riga Technical University* Z–pattern was developed for prognostications indicating the possibility of bankruptcy to be made accordingly to the circumstances of Latvia, but, as concede its authors, it does not take into account peculiarities of industries and is worked out, basing upon a small selection of companies [15].

Latvian pattern:

$$\mathbf{Z = -2,4 + 2,5K_1 + 3,5K_2 + 4,4K_3 + 0,45K_4 + 0,7K_5} \quad (8),$$

where

$\mathbf{K_1}$ - net current assets / total assets;

$\mathbf{K_2}$ - retained earnings / total assets;

$\mathbf{K_3}$ - earnings before taxes / total assets;

$\mathbf{K_4}$ -equity / total debts;

$\mathbf{K_5}$ -net turnover / total assets.

Z < 1, 80 – extremely high possibility of bankruptcy;

1, 81 < **Z** < 2, 7 – bankruptcy is possible;

Z > 3, 00 – possibility of bankruptcy is not prospective or it is very low.

Financial managers have to decide, which tool is better to prognosticate the probability of bankruptcy. Previously discussed patterns are practiced most frequently, but there, of course, are much more. In the course of applying **Z**-patterns for evaluation of business, perhaps, it will turn out that while one pattern overestimates the risk of bankruptcy the other underestimates it. In that case there are alternative ways of using **Z**–pattern, such as:

1) working out a multi–factor pattern of your own by applying the MDA method;
2) putting into practice the existing available patterns and making generalized evaluation in the light of previous results.

The first way includes statistical processing of data bases in major companies. As concerns the second one, it must be said that it is obligatory to determine critical value **Z** in all **Z**–patterns. Deviations to one side or another will indicate the possibility of bankrupt or its absence, besides, the larger is the distance, the higher is the level of credibility. Thus it is possible – within any pattern – to create the scale indicating the possibility of bankruptcy, and in the classical pattern of Altman, for example, it looks like this:

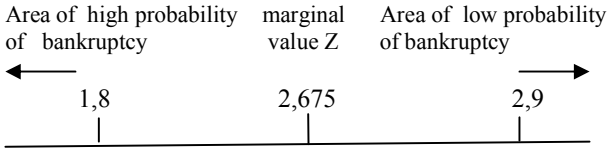

Fig.II The scale indicating the possibility of bankruptcy according the classical pattern of Altman.

To every pattern of **Z** it is own scale with particular parts of this scale. The hardest is respective comparison of different scales in different models. Using statistical indicators and performing this task, it is possible to create universal instrument for prognostication of eventual bankruptcy. The drawback of it is number and complexity of calculations, using available **Z** models.

For more precise prognostication of eventual bankruptcy it is necessary to exploit the whole set of methods and on the base of their results to work out recommendations for management decision making. For smoothing of different results from different models, it is possible to use methods of average values, weighted averages or average quadratic deviation. In every case, the result of such approach is going to be more precise, if compared to any individual method or model.

The great amount of unsuccessful restructuring cases does not decrease the amount of performed restructuring projects because of their potential advantages when compared to the traditional methods of business extension. Therefore the causing factors of failures should be identified during the restructuring and the risks of enacting the restructuring have to be evaluated as well as company financial performance and bankruptcy risk evaluated.

By determining the company's market value, it is concluded by the author that the most used method by Latvian financial analysts – the adapted capital asset pricing model or the cumulative method – does not reflect an adequate price of increasing financial risk. In order to determine adequate equity price correlating with the increasing financial risk along with more aggressive funding structures, the author offers using capital asset pricing method.

V. CONCLUSION

Based on analysis of the importance of restructuring in financial performance improvement the author has concluded the following:

1. Crisis of the company is a difficult financial position threatening the existence of the company and demanding for particular activities in order to recover and retrieve the state of balance. Unlikely the temporary recession of economic activity following the development cycles and rotating with the rising phases, the crisis causes significant failures of the company's activity and performance that can even completely change the company concerning its property, management, personnel and technical matters.
2. In order to eliminate the crisis, the financial position of the company has to be evaluated in a good time, and in case of instable situation set of activities has to be enacted to recover the company. One of the key elements of the system is company's restructuring.
3. Before initiating the restructuring the company's historical data and former position should be evaluated. During this process the strategic financial analysis could

be used. It compares the information obtained with the data of closest rivals and determines the company's position in the industry by performing the analysis of company's external environment. All activities mentioned above must be performed with a target of studying the activities that can be improved by more qualitative and professional management.

4. As one of the most critical restructuring stages the forecasting of future activity may be considered. Based on how qualitative and objective the future forecasts are formed, the investment decision will be made. In order to expected cash flow being objective, the assumptions made should be based not only on company's future perspectives on micro level, but also on the statistics of country's macroeconomic indicators and the expert opinions about country's development.

5. Traditional restructuring task is a maximization of company's market value. Development concept is managed by a defined methodology. In the first stage the company's market value before the restructuring must be calculated by the use of cash flow discounting method or income method.

6. The real restructuring target is gaining additional effect (effect of synergy). As the best quantitative indicator to evaluate the effect, the company's market value indicator concept could be used. To evaluate the company more objectively it is necessary to use at least two of the concepts. For more active companies the income capitalization and discounting the future cash flow methods could be the most appropriate.

7. By determining the company's market value in order to define the minimal profitability or the equity price demanded by the owners, it is recommended to use the *CAPM* model. The use of *CAPM* in the countries without a highly developed stock market, including Latvia, is performed by using the stock index of the geographically and economically closest countries or regions, or the systematic risk coefficient of the industry (beta coefficient).

References:

[1] M. A. Ghazanfari, T. T. Fard, M. T. Sadeghi, „Financial Management approaches with based on organizations and business trade", in Proc. *5th WSEAS International Conference on MANAGEMENT, MARKETING and FINANCES (MMF '11),* Playa Meloneras, Gran Canaria, 2011, pp.138-144. Available:http://www.wseas.us/e-library/conferences/2011/Meloneras/SOMMEM/SOMMEM-20.pdf

[2] J. Van Horne, J. Vachowicz, *Fundamentals of Financial Management*. 12th edition, Prentice Hall Inc., 2005.

[3] E. Brigham, L. Gapenski, *Intermediate Financial Management*. 4th edition. The Dryden Press, 2008.

[4] P. Howson, *Due Diligence: The Critical Stage in Mergers and Acquisitions*. Gower Publishing Ltd, 2003.

[5] J. Sedlaček, P. Valouch, A. Konečny, „Development Trends at Markets with Mergers and Acquisitions in 2001–2010", in Proc. *2nd WSEAS International Conference on FINANCES and ACCOUNTING" (MMF '11)*, Montreux, 2011, pp.106-. Available: http://www.wseas.us/e-library/conferences/2011/Montreux/AMI/AMI-00.pdf

[6] E. Dockery, W.E. Herbert, Corporate governance and enterprise restructuring in transition economies: evidence from privatized Polish companies. *Journal of Managerial Finance*, Volume 26, Issue 9, 2000, pp. 80 – 92.

[7] R. L. Crum., I. Goldberg, *Restructuring and Managing the Enterprise in Transition*. The international bank for Reconstruction and Development. The World bank. Washington, USA, 1998.

[8] P. Fernandez, *Company valuation methods. The most common errors in valuations* **.** Social Science Research Network, 2007, 31p. Available : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=274973

[9] A. Damodaran, *Finding the Right Financing Mix: The Capital Structure Decision*. New York: Stern School of Business, 2009.

[10] , F.W. Sharpe, *Capital Asset Pricing Model*. Netherland: Value Based Management, 2008. Available : http://www.valuebasedmanagement.net/methods_capm.html

[11] M. N. Bahram, „Reviewing of Strategic Planning and Management on privatization process" in Proc. *5th WSEAS International Conference on MANAGEMENT, MARKETING and FINANCES (MMF '11),* Playa Meloneras, Gran Canaria, 2011, pp.73-80. Available:http://www.wseas.us/e-library/conferences/2011/Meloneras/SOMMEM/SOMMEM-20.pdf

[12] A. Olaru, A. Capatina, „The analysis of performance control management system within Romanian IT companies" in Proc. *5th WSEAS International Conference on BUSINESS ADMINISTRATION (ICBA '11),* Puerto Morelos, Mexico, 2011, pp. 11-15 Available: http://www.wseas.us/e-library/conferences/2011/Mexico/ICBA/ICBA-01.pdf

[13] CFA Institute. *Financial Statement Analysis.* CFA® Program Curriculum Volume 3. ASV: Pearson Custom Publishing, 2008.

[14] E. Altman, The success of business failure, empirical research in accounting. *Journal of Accounting Research*.1966.-Nr. 4., 17p.

[15] I. Mavļutova, Uzņēmumu maksātnespējas prognozēšanas metodika. *Bilance,* 2007, Nr.1, pp.13.-15.

Inese Mavlutova Dr.sc.administr is Assosiete Professor of BA School of Business and Finance in Riga, Latvia. After graduation of Moscow State University and obtaining degree in Economic sciences she has spent long years of her professional carrier in both academic field and practical business consulting in the area of financial management of business organizations. She is an author of monograph and several scientific articles published in internationally recognized journals.