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Cash Flows from Financing Activities. Evidence from the Automotive Industry

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Abstract *The statement of cash flows is among the key financial statements which companies should prepare according to the Generally Accepted Accounting Principles. In Turkey, the uniform accounting system accepts the cash flow statement as a supplementary financial report. On the other hand, publicly traded companies prefer the Turkish Accounting Standards in preparing their cash flow statements. Cash flows from financing activities form one of the major parts of this statement as the financial strategies of companies. The aim of this study is to analyze the cash flows from the financing activities of a sample company from 2011 to 2014 in the Turkish Automotive Industry and to show its related strategy. The company's financing activities involve cash inflows and cash outflows as it is normally observed in the literature. In addition, the share of bank loans and dividends demonstrate the significance of debt and dividend policy with regard to financing activities.*

Key words Automotive industry, cash flows, cash flow statements, financing activities, horizontal analysis

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1. Introduction

Cash flow is an essential element of financial management process which is important for the successful performance of business organizations. According to Titman, Keown and Martin (2011), cash flows create value. In addition, they are regarded as a real resource for company expenditures. In this respect, cash can be used for transactions such as the payment of wages, salaries and debt, acquisition of inventory or goods as well as the distribution of profits (Bhandari and Iyer, 2013). Specifically, banknotes and coins mean cash in daily transactions. On the other hand, short term investments and money at banks are additionally considered as an important liquidity source in accounting or financial analysis. Firms' liquid assets consist of these near-cash assets which are called cash equivalents (Vause, 2014). (Libby, Libby and Short, 2014) describe a cash equivalent as "…a short-term, highly liquid investment with an original maturity of less than three months."

The key financial statements provide the essential information for investors and analysts because of the accrual accounting system, which is compulsory for business transactions. Accrual accounting system is the result of the revenue recognition and the matching principle in accounting. In this system, revenues and expenses are the major elements of income statements. Therefore, it is possible and even certain for a firm to have excessive cash outflows which arises during the fiscal year. This highlights the significance of cash basis accounting, which considers only cash receipts and cash payments in business transactions (Bhandari and Iyer, 2013; Kramer and Johnson, 2009).

The Turkish automotive industry has a distinctive framework and links with other industries. As a consequence, it is one of the key industries in Turkey, which could be observed by examining the share of automotive exporting companies among various industrial enterprises (Kara and Erdur, 2015). The competitiveness of the Turkish automotive industry is due to a number of factors such as capital structure, partnerships, workforce, location and quality controls. Nevertheless, the industry faces some organizational and operational problems as well (Gorener and Gorener, 2008). In addition, the research by KPMG Turkey (2014) highlights that the automotive industry is continuously growing. As a result, there will be a rise in the importance of capital structure management. In this respect, the average debt ratio is 62,4 % in the automotive industry from 2011 to 2014 which demonstrates the influence of liabilities in financing (TCMB, 2012; TCMB, 2015). Therefore, the financial strategies of Turkish automotive firms could be observed during the process of cash flow statement analysis. The aim of this study is to demonstrate how financing activities lead to cash inflows or outflows in one of the most important companies in the Turkish automotive industry.

2. Literature review

2.1. Cash Flow Statement

Cash receipts and disbursements are presented on cash flow statements, which serve the purpose of determining companies' strength in achieving their financial objectives (Boyd and Cortese-Danile, 2000; Jabbari, Sadeghi and Askari, 2013). In other words, more specifically, (Taillard, 2012) argues that cash flow statements are considered helpful in the determination of liquidity and profitability, assessment of operational asset and financial management. As Bhandari and Iyder (2013) forecast business failure with the help of cash flow statement related indicators and highlight their significance through discriminant analysis. Moreover, Faurescu and Duta (2011) assess managerial performance of selected companies by using cash flow statements and income statements in Romania. It is significant to underline that cash flow statements show historical information about companies' performances, which is one of the common characteristics of key financial statements (Tan, Robinson and Schilit, 2014).

In Turkey, cash flow statements have been supplementary financial statements for a long time. In addition, they were not necessary for all Turkish companies because of the Turkish Uniform Accounting System which was founded in 1994. This legislation only considers cash inflows and cash outflows during the accounting period as it could be seen in Table 1. Consequently, the format of the statement of cash flows is different compared to the one which is prepared under the Turkish Accounting Standard 7.

Table 1. The Format of the Cash Flow Statement under the Turkish Uniform Accounting System

A	Cash balance at the beginning of the period
B	Cash inflows during the period
C	Cash outflows during the period
D	Cash balance at the end of the period (A+B-C)
E	Increase or decrease in cash flows (B-C)

Source: Akguc (2013)

However, they are currently among the key financial statements with respect to the Turkish Accounting Standards, which were adopted to meet the accounting standards at international level. Turkish Accounting Standard 7 is concerned with the formation and demonstration of the cash flow statement (Kargin and Aktas, 2011).

2.2. Sections of the Cash Flow Statement

There are three sections on the statement of cash flows. These are cash flows from operating activities, cash flows from investing activities and cash flows from financing activities (Carslaw and Mills, 1991). The Turkish Accounting Standard 7 has also recognized these sections of the cash flow statement in Turkey (Akguc, 2014). The sum of these cash flows is equal to the net change in cash and cash equivalents, which could be observed by comparing cash accounts in two subsequent statements of financial position. As a result, it is possible to note that cash flow statements and balance sheets are related (Mc Laney and Atrill, 2014). Income statements are also necessary for the determination of cash flows. As Faurescu and Duta (2011) note, "the income statement presents the information of the type of incomes, expenses and results released by the various activities which represent key information on sources and uses of liquidities and liquidity equivalents."

2.2.1. Cash Flows from Operating Activities

This section demonstrates cash inflows and outflows which arise from revenues and expenses. In this respect, income statement and statement of financial position should be used to identify the amount of cash inflow or outflow. Cash sales and cash collections from trade receivables constitute cash inflows from these activities. On the other hand, cash payments for inventories, operating expenses, taxes, interests and dividends are considered as the cash outflows. In addition, this section is regarded as crucial for companies since it highlights their success in operations and working capital management (Libby, Libby and Short, 2014; Berry, 2011; McLaney and Atrill, 2014). (Jabbari, Sadeghi and Askari, 2013) suggest that operating cash flows are inversely related to stock price crash risk in their analysis on Tehran Stock Exchange from 2006 to 2010.

Two methods are available for the determination of cash flows from operating activities. The first method, which is called as the indirect method, expresses net income on cash basis by making adjustments for non-cash items. Nevertheless, the second method or the direct method, considers comprehensive cash flows by examining accounts related to operating activities (Berry, 2011). There are three important features of this method. Firstly, it allows the total amount of operating cash receipts and payments to be seen on cash flow statements. Secondly, it is only suitable for operating activities. As a result, there is not any need to choose this method to determine financing and investing activities. Thirdly, it is suggested by the Financial Accounting Standards Board due to its ability to demonstrate the financial health of companies particularly with respect to working capital management (Boyd *et al*., 2014). This arises from the inexistence of accrual based adjustments in the direct method (McLaney and Atrill, 2014).

2.2.2. Cash Flows from Investing Activities

The purchase and sale of long term assets form cash flows from investing activities (Titman, Keown and Martin, 2011). Cash inflows are associated with the sale of long term assets such as buildings. On the other hand, cash outflows occur through long term asset purchases (Berry, 2011). In general, there could be a cash inflow or outflow from investing activities. On the other hand, cash inflows may sometimes be equal to cash outflows (Taillard, 2012). Future investments determine the growth and the chance of survival (Orhan and Basar, 2015). As a result, cash is regularly invested in productive assets. Among these assets, property, plant and equipment are essential for growth. Moreover, there could be need for intangibles and long-term securities of other companies. As a consequence, useful information could be obtained with respect to management strategy and long term financial planning (Boyd and Cortese-Danile, 2000). The cash inflows from the sale of long-lived assets occur because of various reasons. In the first place, the amount of cash from operating activities may not be sufficient. In the second place, there may be a good opportunity to dispose of those assets. Alternatively, assets may have completed their economic life, which also requires their removal. Nevertheless, it is important to highlight that selling assets may also arise because of companies' lack of access to funds. Therefore, this may be regarded as a serious issue for companies (Jeter, 2005).

2.2.3. Cash Flows from Financing Activities

This is the third part of the statement of cash flows. Before explaining these activities, it is important to understand what financing means. Taillard (2012) describes financing as "…the process of acquiring capital to fund a start-up, an expansion, basic operations or whatever else the company needs the extra funds for." Financing could be either internal or external. Retained earnings are the resources for internal financing. However, external financing involves two key resources which are equity and debt. The sale of company shares to investors provides cash. Whereas, loans and the sale of bonds constitute the methods for debt financing. Consequently, financial markets should be used for external funds (Subramanyam and Wild, 2014). Cash flows from financing activities is defined as "…the remaining of activities that cannot be classified either as operating or investing" (Kousenidis, 2006). Precisely, cash investments of company owners, cash repayments of loans, cash dividends received by shareholders and the supply of stocks or bonds constitute these cash flows (Kramer and Johnson, 2009; Williams, Haka, Bettner and Carcello, 2014).

Cash investments of company owners refer to share repurchases which arise due to their sale by some shareholders (Mc Laney and Atrill, 2014). There are various reasons for this to occur. Firstly, there could be a decrease in share prices which provides a good opportunity for share acquisitions. Secondly, these shares could be a part of company strategy to protect itself from hostile takeovers. Thirdly, they could be given to key executives for additional compensation (Kramer and Johnson, 2009). Cash repayments of loans exist as a result of the loans which are provided for companies. In this respect, cash is necessary in satisfying the expectations of creditors. As a result, they influence financing activities adversely. On the other hand, cash dividends are one of the ways to utilize money in companies. Therefore, they have the same effect as cash repayments on cash flows from financing activities (Taillard, 2012).

Financing activities may produce cash inflows or outflows which are affected by financial strategies of companies. For instance, in the period of expansion, cash inflows are usually observed since there could be insufficient cash flows from operating activities which requires the sale of shares or debt securities for the maintenance of company operations. In contrast, operations need relatively lower amount of financing in the period of maturity (Mc Laney and Atrill, 2014; Tan, Robinson and Schilit, 2014). More specifically, the supply of stocks or bonds in financial markets could be regarded as the essential cash resources for firms (Boyd *et al*., 2014). With respect to financing, (Kargin and Aktas, 2011; Tian, Han and Zhang, 2015) describe cash flow patterns by considering business cycles. Furthermore, (Orhan and Basar, 2015) note that there are cash outflows related to financing activities of the companies listed on Istanbul Stock Exchange 100 Index. As a result, companies' financial structure or the exchange of cash between the firm and its shareholders and creditors could be clearly observed by examining this part of the cash flow statement (Vause, 2014). In Turkey, most companies use their retained earnings and short-term bank credits for financing because of the insufficiency of long-term resources in capital markets. These resources are mostly used by the government through the issuance of government bonds due to budget deficits (Gursoy, 2012). Therefore, companies, which have access to long-term resources, could be regarded as financially strong. The amount of these resources might be observed in financial statements. In this respect, cash flow statements help analysts to understand the use of long-term and short-term financial resources on cash basis (Libby, Libby and Short, 2014).

3. Methodology of research

3.1. Horizontal Analysis

In this study, cash flow statements are analyzed by horizontal analysis. This method is useful in observing annual increases or decreases in all financial statement items and identifying the reasons and effects of these increases or decreases (Hilton and Platt, 2014). Horizontal analysis deals with the comparison of financial statements of two consecutive periods which provides analysts the opportunity to see the developments in terms of amounts and percentages. As a result, it is possible to understand how financial statement items may differ substantially compared to the amounts in a previous or base year (Pazarceviren, Ozsuer and Dede, 2015; Subramanyam and Wild, 2014). The analysis should be done by choosing an ordinary year as a base year otherwise; there will be inappropriate evaluations with respect to the changes in financial statement items (Gencoglu, 2014). The calculation of the increases or decreases in financial statement items could be examined in Table 2.

Table 2. Changes in Financial Statement Items in Horizontal Analysis

	Amount		Change	
Financial Statement Item	First Year	Second Year	Amount	%
	X	Y	(Y-X)	(Y-X)/X

Source: (Toroslu and Durmus, 2015)

In horizontal analysis, the determination of a percentage change depends on the value of the base year. Provided it is negative or zero, it will not be possible to express percentage changes in financial statements (Williams *et al*., 2014). On the other hand, the negative percentage change is 100 provided financial statement items only have a value in the base year (Akguc, 2013).

3.2. Research Sample

Otokar is selected in order to analyze cash flows from financing activities in the Turkish Automotive Industry. It is a manufacturing company which produces commercial vehicles and defense industry products. Otokar was established in 1963 and currently employs 2100 personnel in Sakarya, which is in the north west of Turkey. Regarding key financial indicators, it is among the successful companies in the Turkish automotive industry. There was a rise in Otokar's net sales from 2011 to 2014, which was also observed with respect to net profits, total assets and shareholders' equity. Net profits, which were 54.846.604 TL in 2011, increased to 72.771.198 TL in 2014. On the other hand, net sales rose from 890.525.185 TL to 1.401.552.934 TL during this period (Otokar, 2012; Otokar, 2014).

The company's financial structure could be seen with the help of financial ratios in Table 3. The leverage ratio and shareholders' equity to total assets demonstrate that the company mainly uses debt to finance its operations which is also observed in the industry. Nevertheless, the leverage ratio of Otokar is higher than the leverage ratio in the industry. As a result, it is reasonable to suggest that debt is dominant in creating cash flows from financing activities.

Table 3. Leverage and Financial Structure Ratios of Otokar

%	2011	2012	2013	2014
Total Debt/Total Assets	75	77	80	80
Shareholders'Equity/Total Assets	25	23	20	20
Current Liabilities/Total Liabilities	64	51	49	52
Short-term financial liabilities/Total Liabilities	11	5	10	2
Long-term financial liabilities/Total Liabilities	10	23	24	22

Source: Otokar (2012); Otokar (2014); Authors' calculations from the company's financial statements

4. Research analysis and findings

As horizontal analysis requires minimum two years' financial statements, the examination period is restricted to the past four years of the company. In addition to this, Otokar's cash flow statements are preferred since they are not consolidated. Consolidated financial statements have some disadvantages with respect to financial analysis. Firstly, these statements may not be reliable because of the existence of various companies' combined data. Secondly, accounting systems and valuation techniques may differ among these companies, which is unfavorable in terms of the quality of financial statements. Thirdly, the increase or decrease in exchange rates may influence the financial statement items of a subsidiary considerably (Akdogan and Tenker, 2007). The cash flow statements of Otokar reveal that the company had cash inflows and cash outflows from operating activities. As a consequence, operating cash flows were volatile in this period. Although, there was a decrease from 2012 to 2014, investing activities regularly produced cash outflows. On the other hand, there were cash inflows from financing activities except 2014. It is important to highlight that the company's main financing activities comprise the use of bank loans and the distribution of dividends.

Table 4. The Cash Flow Statements of Otokar

	2011	2012	2013	2014
Net Cash Flows from Operating Activities	(80.028.286)	70.145.484	(53.000.184)	350.387.908
Net Cash Flows from Investing Activities	(49.325.078)	(69.590.619)	(62.122.782)	(52.712.260)
Net Cash Flows from Financing Activities	22.259.046	42.880.956	76.100.895	(262.032.125)
Proceeds from bank borrowings	355.485.394	422.112.861	352.349.508	262.582.894
Repayments of bank borrowings	(314.943.429)	(324.424.422)	(186.193.000)	(389.251.873)
Interest payments	(6.160.392)	(17.030.560)	(26.377.939)	(36.824.530)
Interest received			322.326	1.461.384
Dividends paid	(15.000.000)	(48.000.000)	(64.000.000)	(100.000.000)
Realized gains from forward transactions, net	2.887.473	10.223.077		
Net Increase/Decrease in Cash and Cash Equivalents	(107.094.318)	43.435.821	(39.022.071)	35.643.523
Cash and cash equivalents at the beginning of the year	111.564.742	4.470.424	47.906.245	8.884.174
Cash and cash equivalents at the end of the year	4.470.424	47.906.245	8.884.174	44.527.697

Source: Otokar (2012); Otokar (2014)

The horizontal analysis of the cash flow statements of Otokar shows that there was a considerable increase in the operating cash flows compared to 2011. Investing activities, which rose in 2012, started to decline gradually until 2014. However, there was little increase from 2011 to 2014. Financing activities also increased from 2011 to 2013. Subsequently, this was followed by a significant decrease in 2014. Otokar produced expected cash flows from its activities in 2012 and 2014. On the other hand, it had a different performance in other years.

Table 5. Horizontal Analysis of Otokar's Cash Flow Statements

	2011-2012	%Change	2011-2013	%Change	2011-2014	%Change
Net Cash Flows from Operating Activities	150.173.770	-	27.028.102	-0,34	430.416.194	-
Net Cash Flows from Investing Activities	-20.265.541	0,41	-12.797.704	0,26	-3.387.182	0,07
Net Cash Flows from Financing Activities	20.621.910	0,93	53.841.849	2,42	-284.291.171	-12,77
Proceeds from bank borrowings	66.627.467	0,19	-3.135.886	-0,01	-92.902.500	-0,26
Repayments of bank borrowings	-9.480.993	0,03	128.750.429	-0,41	-74.308.444	0,24
Interest payments	-10.870.168	1,76	-20.217.547	3,28	-30.664.138	4,98
Interest received	-	-	322.326	-	1.461.384	-
Dividends paid	-33.000.000	2,2	-49.000.000	3,27	-85.000.000	5,67
Realized gains from forward transactions, net	7.335.604	2,5	-	-	-	-
Net Increase/Decrease in Cash and Cash Equivalents	150.530.139	-	68.072.247	-0,64	142.737.841	-
Cash and cash equivalents at the beginning of the year	-107.094.318	-0,96	-63.658.497	-0,57	-102.680.568	-0,92
Cash and cash equivalents at the end of the year	43.435.821	9,72	4.413.750	0,99	40.057.273	8,96

Source: Author's own calculations

Since companies sometimes have limited access to share capital, cash inflows could only be gained by using long-term loans or debt securities with respect to financing activities (Akguc, 2014). Consequently, there were mainly cash inflows from long term loans as it is observed in footnotes to its financial statements from 2011 to 2014 (Otokar 2012; Otokar, 2014). It is essential to emphasize that financing options will be limited provided that there is continuous use of debt (Tan, Robinson and Schilit, 2014). Therefore, Otokar should consider the availability of funds in developing its financial strategy in the future.

The company has been distributing dividends despite the existence of cash outflows from operating activities in 2011 and 2013. The rise in dividend payments shows the importance of dividend policy (Otokar Financial Results 2014). Dividends have been fixed at 50 percent of the distributable income for the past four years. Therefore, retained earnings increased by 17.4% from 2011 to 2013. However, there was a decrease by 18% in the level of retained earnings from 2013 to 2014 (Otokar, 2012; Otokar, 2014). As part of a risk management strategy, the company used forwards and had cash inflows in 2011 and 2012. In addition to this, it started to gain interest in 2013, which demonstrates unexpected cash inflows from financing activities (Akguc, 2014). The use of equity or debt could be helpful in the growth of companies which meets the expectations of company investors and creditors due to the rise in sales and profits. On the other hand, it is essential to note that there should be a sufficient amount of cash from operating activities. Otherwise, there will be a larger need of debt or equity for debt repayments (Boyd *et al*., 2014) As a result; cash flows from operating activities demonstrate the credibility of earnings. In this respect, they should exceed the level of net income and be used for the fulfillment of investing and financing activities (Jeter, 2005; Francis, 2010). This was not the case for Otokar from 2011 to 2013, which is unfavorable in terms of its performance and therefore sustainable growth (Otokar, 2012; Otokar, 2014). Nevertheless, Otokar managed to increase its cash flows from operating activities in 2014, which is essential for the survival of the firm (Otokar, 2014; Williams *et al*., 2014).

5. Conclusions

This study examined the cash flows from the financing activities of one of the leading companies in the Turkish Automotive Industry. It would be more appropriate to increase the data sample in order to provide clear information about the financing activities in the industry. On the other hand, it could be suggested that the study contributes to the literature on cash flow statements as it explains their sections and emphasizes the main difference between the uniform accounting system and the Turkish Accounting Standard with respect to the format of these statements. As key financial statements, cash flow statements show the operating, investing and financing activities of companies and support the accrual accounting system due to their characteristics. When the cash flow statements of Otokar are examined from 2011 to 2014, it could be seen that the company's financing activities led to cash inflows and outflows which is also observed in the literature. It is essential for the company to maintain an appropriate level of cash from operating activities in order to continue its operations and improve its shareholders' wealth since operating activities are regarded as the main sources of cash. As a consequence, it should focus on developing strategies to achieve this objective in the future.

One of these strategies could be the utilization of dividend policy which may support the continuous improvement of stockholder equity through gradual increase of retained earnings. This is an effective way of creating a very valuable internal financing that would support a sustainable growth of the firm. This may have a strong effect on short and long term borrowing ability vis-à-vis the banking system. Thus, while improving the cash flow management system process through the dividend policy, the firm would also be able to strengthen its equity position and therefore its credibility with a healthy and sustainable growth objective.

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