Due diligence matrix for main user groups of financial analysis

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Abstract

Today the financial analysis indicators of an enterprise are topical for both internal and external users of an enterprise. Unfortunately, often to analyze the financial status of an enterprise and to identify the potential of an enterprise, it is not enough to have customary financial analysis indicators.

In this paper, the data of the research that was conducted by the end of the year 2013 has been used. 1935 respondents took part in the survey – representatives of the leading business sectors in Latvia and representatives of the large and medium-sized enterprises. In the research, the authors have applied quantitative and qualitative methods of economics such as the mathematical and statistical methods.

As a result of the research, the author of the paper suggests the enterprises in Latvia in six leading branches of business to use the due diligence matrix for both internal and external user groups. The due diligence matrix is a unified specification of the financial analysis of an enterprise, that will help to identify the potential of an enterprise for each group of financial analysis users in a cost-effective manner unlike full procedure of due diligence.

Keywords: Matrix; due diligence; financial analysis.

1. Introduction

Analysis of a financial condition allows identifying already existing and just emerging economical problems and bringing them to the attention of enterprise leaders. Financial analysis plays an important role in taking thought-out administrative solution by suggesting an analytical study. Unfortunately, to date it is not enough to have only
financial analysis ratios for identification of a full and thorough financial condition of the enterprise. Financial statements, on which basis financial ratios are analyzed, reflect the situation in details on past periods and financial condition of the enterprise to date, but it does not reflect the potential of the enterprise.

To date the potential of an enterprise is one of the main indicators for both internal and external users of the enterprise. In authors’ opinion, one of the main problems that the users of financial analysis are faced by is the lack of information about the potential of an enterprise. Therefore, it is important to research which methods along the financial analysis can be used to obtain a relevant information base for decision-making.

One of the tried and trusted ways to identify the potential of an enterprise is due diligence. Due diligence is one of the main tools in identifying the potential of an enterprise, where broad procedures and different fields of enterprise verification are used. Currently due diligence procedure may be covered by following fields of enterprise verification: financial, legal, environmental, management, marketing, manufacturing, information technological, reconciliatory, compatibility verification (Gillman, 2010).

Due diligence is a reasonable level for verification of financial aspects, that have a significant impact on perspectives of business prospects in the future. (Guzev, Savenokova, 2012).

Due diligence is one of the procedures we use to study, investigate and evaluate a business opportunity. (Bing, 1996).

The author of the paper suggests to use the elements of due diligence, in addition, for the optimization of an enterprise the author suggests to develop a due diligence matrix, where for each financial analysis user group will be used it’s own element of due diligence.

The aim of the paper is to develop a due diligence matrix for main users of financial analysis.

In comparison to financial analysis in general, due diligence emerged relatively recently. From the recent publications, that are describing different aspects of due diligence, authors are using following publications of A.Lajoux (Lajoux, 2007), L.Gillman (Gillman 2010), Y.Guzov (Guzov, 2012), G.Bing (Bing, 1996), W.J.Gole (Gole, 2009), P.Howson (Howson, 2012), D.Roodman (Roodman, 2011), M.Peppitt (Peppitt, 2009), W.M.Crilly (Crilly, 2010), L.Culick (Culick and etc., 2004), L.S.Spedding (Spedding, 2005), R.Gleich (Gleich and etc., 2012).

2. Method

To reach the aim in this paper authors are using a quantitative method of questionnaire survey that will help to understand how broad due diligence method is demanded in the enterprises of Latvia. In the questionnaire survey, developed by authors, the data of statistical bureau of Latvia is broadly used. In this regard the authors are using scientifically deductive method, that allows logically systemize and explain gained data of empirical research. The data comparison method is used in the practical part of the paper. Graphical analysis allows authors to more clearly display the results of the survey. In this study authors marks the main financial analysis groups and notes the leading branches of businesses of Latvia, which contributes to formation of due diligence matrix.

3. Results

After the study in this paper and previous works, authors have analyzed due diligence procedures and offered her own collection. Table 1 shows four main groups, which includes both external and internal users of the results of enterprise’s financial analysis.
Table 1. The level of importance (demand) in conducting due diligence procedures for different groups of users of the results (high/low) of financial analysis

<table>
<thead>
<tr>
<th>Due diligence procedure</th>
<th>Short description of due diligence procedure</th>
<th>Shareholders</th>
<th>Creditors</th>
<th>Investors</th>
<th>Company executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analysis of the constituent documents and the formation of the authorized capital</td>
<td>D1</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>low</td>
</tr>
<tr>
<td>Analysis of the documents that are regulating internal operations of the organization and labour relations for the period under review</td>
<td>D2</td>
<td>high</td>
<td>low</td>
<td>low</td>
<td>high</td>
</tr>
<tr>
<td>Analysis of the permit documentation that is necessary for legal functioning of business for the period under review</td>
<td>D3</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>Verification of compliance with the requirements of regulations on the amount of the net assets of the enterprise</td>
<td>D4</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>low</td>
</tr>
<tr>
<td>Analysis of accounts payable and receivable for the date under review</td>
<td>D5</td>
<td>low</td>
<td>high</td>
<td>low</td>
<td>high</td>
</tr>
<tr>
<td>Verifications of documents, that are certifying the right to movable and immovable property for the required period</td>
<td>D6</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>low</td>
</tr>
<tr>
<td>Analysis of the enterprise's main contracts</td>
<td>D7</td>
<td>high</td>
<td>high</td>
<td>low</td>
<td>high</td>
</tr>
<tr>
<td>Description of the property, that is reflected in accounting statements of the enterprise as at the date under review</td>
<td>D8</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>low</td>
</tr>
<tr>
<td>Characteristics of the applied methodology of accounting statement procedure, tax accounting, preparation of accounting statements for the period under review</td>
<td>D9</td>
<td>high</td>
<td>high</td>
<td>low</td>
<td>high</td>
</tr>
</tbody>
</table>

Source: the author's research

In the Table 1, authors of the paper are naming the main due diligence procedures for the leading groups of users, at the same time reflecting the level of importance of each procedure for different groups of users.

In order the undertaken financial analysis of an enterprise could be broaden, authors of this paper suggests elaborated matrix of demanded modified financial analysis ratios in the context of user groups and the main profitable economic businesses of Latvia, based on the data from Statistical Bureau of Latvia.

Table 2. Matrix of the groups of the users of enterprises’ financial analysis results in the context of leading businesses of Latvia, using due diligence procedures

<table>
<thead>
<tr>
<th>User group/sector of economy</th>
<th>Shareholders</th>
<th>Creditors</th>
<th>Investors</th>
<th>Company executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
<tr>
<td>Construction</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
<tr>
<td>Agriculture, forestry, fishery</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
<tr>
<td>Services</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
<tr>
<td>Trade</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
<tr>
<td>Transport and storage services</td>
<td>D1-D4, D6-D8</td>
<td>D1, D3-D6, D8-D9</td>
<td>D1, D3-D4, D6, D8</td>
<td>D2-D3, D5, D7, D9</td>
</tr>
</tbody>
</table>

Source: the author's research

As a result, based on the questionnaire survey, authors of the paper outlined the role of the financial analysis in Latvia and its demand on the enterprises. Owing to questionnaire survey, authors have shown the confidence of entrepreneurs in financial analysis. In this paper, the author reflects spheres of businesses of Latvian enterprises, based on the statistical data and on the gross domestic product.
For each group of financial statement analysis users and sphere of business, authors proposes to use its own due diligence procedure's groups. In the Table 2 displayed partial due diligence matrix, in this version it may help to optimize costs of the enterprise and simplify procedures in both time and cost.

4. Conclusions

Based on the data of Statistical Bureau of Latvia, one can conclude that the leading branches of business are production, construction, agriculture, forestry, fishery, services, and trade, transport and storage services.

According to the survey of large and medium enterprises of Latvia, it can be concluded that the analysis of financial statements is not in demand, since the experts hold an opinion, that the analysis of financial statements not always reflects the real financial situation of the company.

As stated by the questionnaire survey, medium enterprises of Latvia are using only basic financial analysis ratios or in general are using them formally in preparation of annual report.

Most of the survey enterprises of Latvia agree that now the ratios of financial accounting analysis not always reflect the real situation at the enterprise.

Today's financial accounting analysis allows the analysts of the enterprises to identify the result of past periods and present situation, but do not allow seeing company's potential in detail.

Large companies of Latvia agree with the opinion that financial ratio analysis is in need for modification and elements from due diligence can contribute to more accurate reflection of the situation at an enterprise.

Due diligence procedure is a disclosure of enterprise's potential, which is important for all four-user groups: shareholders, creditors, investors and company executives.

Today due diligence procedure in its entirety is a very expensive service and only large companies can afford it. The proposed due diligence matrix should help the leading business branches' user groups of enterprises in Latvia in financial accounting analysis.

Choosing the right and true ratios for a particular branch of business is a very time-consuming work; in this regard, the author in her further articles will offer a matrix of financial ratios for the main business branches of financial analysis and for four user groups, such as shareholders, creditors, investors and company executives.

The approbation of the due diligence matrix the author is planning to present in her further articles, jointly with modified ratios of financial analysis.

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