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Improvement of Enterprise Financing System in Unstable Economic Environment

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Abstract

The paper focuses on the development of approaches to improving enterprise financing in an unstable economic environment. It is established that enterprise financing can be consistently addressed as a logically built structure of sources and forms of accumulation of financial resources and the methods to control their accumulation and use. It is proved that the formation of a specific model for the establishment of the sources and forms of enterprise financing can be influenced by many factors, particularly, enterprise income taxation specifics, rates and sustainability of sales growth, and asset structure. It is identified that efficient business is impossible without attracting debt (leverage). The use of debt helps to achieve significant business expansion, improved performance of equity, faster formation of special funds, and improved enterprise market value.

Keywords: System; Financing; Enterprise; Economics; Debt; Profit; Result.

1. Introduction

Attracting financial resources and relying on diverse sources and forms of capital attraction are integral for enterprise development in an unstable economic environment. Alongside equity, which is, for most enterprises, the primary pier of their resource base and asset formation, economic entities in the market economy rely on various forms of borrowed capital. This enables them to take advantage of financial leverage and achieve improved financial results. A well-arranged process to attract and use debt opens up the potential to increase the enterprise market value and sustains stable liquidity and profitability.

However, inappropriate accumulation and irrational structure of debt can cause financial risks and, where such risks are ignored, destabilize the financial position of the enterprise and even lead to its bankruptcy. Therefore, the arrangement of an enterprise financial system is an important functional financial block and also a topical area of research.

The issues of improvement of enterprise financing systems in an unstable economic environment have been covered in the works by Belyaeva (2015), Zhukov (2015), Ershov and Kuzin (2016), Kuruzov (2014), Nosova (2016), Pichugin (2015) and others. Even though the topics of enterprise financing are well-researched, there is not sufficient academic coverage of enterprise financial systems in an unstable economic environment. Most researchers emphasize the evaluation of financial flows and their influence on the efficiency of equity and debt. Up for discussion are the aspects of identifying the essence of enterprise financing, the development of methods to improve the structure of liabilities and to estimate the efficiency of their accumulation and use.

2. Methods

The methodology of the research is based on the system approach, the methods of scientific abstraction, analysis and synthesis, the dialectic method in studying economic phenomena, the postulates of improving enterprise financing system in an unstable economic environment. Specific tasks in the paper were approached using the following methods: the methods of theoretical generalization, logical reasoning, scientific abstraction, associations

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and analogies were used to study and summarize the methodological basis of enterprise financial flow management; the methods of systems analysis, generalization, and comparison were used for studying the methodological approaches and techniques of conducting the performance analysis of enterprise financial management.

The information base of the study comprises laws and regulations, statistical materials of public authorities and local government, academic publications of national and international scholars on the issues of improvement of enterprise financing systems in an unstable economic environment (Cherkasov *et al.*, 2017; Zavalko *et al.*, 2017a; Zavalko *et al.*, 2018).

The research aims to develop approaches to financial flow management at an enterprise and substantiate approaches to strategic management of the enterprise financial system. Moreover, the task is set to explain the financial system of an enterprise and identify and articulate the main lines of enterprise development in an unstable economic environment.

3. Results

In the market economy, the competitiveness of an economic entity and its potential to achieve strategic goals are to a significant extent linked to the adequacy of its financial resources. Determining the required amount and optimal structuring of financing constitutes a key issue of managing an enterprise. The problem becomes extremely important in an unstable economic environment when traditional sources of enterprise financing are unavailable.

The drop-in lending in the economy, worsening financial results of the majority of enterprises, and limited opportunities for efficient capital raising in capital markets have increasingly brought to the foreground the issue of finding new sources of funding to support development. However, thorough research of the financial basis of the discussed phenomena is necessary to compile practical recommendations for improving the practices of enterprise financing.

Generally, financing refers to measures aimed to cover the enterprise capital needs, which includes attracting financial resources (cash and equivalents and physical assets), their repayment, and the relationship involved between the enterprise and the creditor (payment relations, control and security). The accumulation of funding for the enterprise relies on various forms and methods, which jointly shape the essence of financial activity of the economic entity.

Financial activity refers to activities resulting in changes in the amounts and structure of the enterprise's equity and debt. Moreover, the enterprise financing process includes operations relating to the accumulation of equity, payment of dividends, buybacks of previously issued shares, acquiring and repayment of loans, collection of proceeds from the issuance of bills of exchange and bonds.

We find it questionable to only partially include transactions linked to changes in the levels of current liabilities in the enterprise financing process. In our view, accounts payable owed to counterparties and the state can be also reasonably approached as an important source of financing for the enterprise, given that, before it becomes due, the enterprise can channel this debt to support its operations.

At the same time, enterprise financing constitutes a system of employing various forms and methods of financial support to sustain operations and achievement of goals, which system aims at the major tasks, particularly, providing financial support for operational and investment activity; identification of income growth potential; improving profitability and solvency; due performance of obligations to economic entities, budgets of all levels, and banks; accumulation of financial resources in the amounts needed to adequately finance the enterprise development, and increase of equity; control over the efficient allocation and use of financial resources.

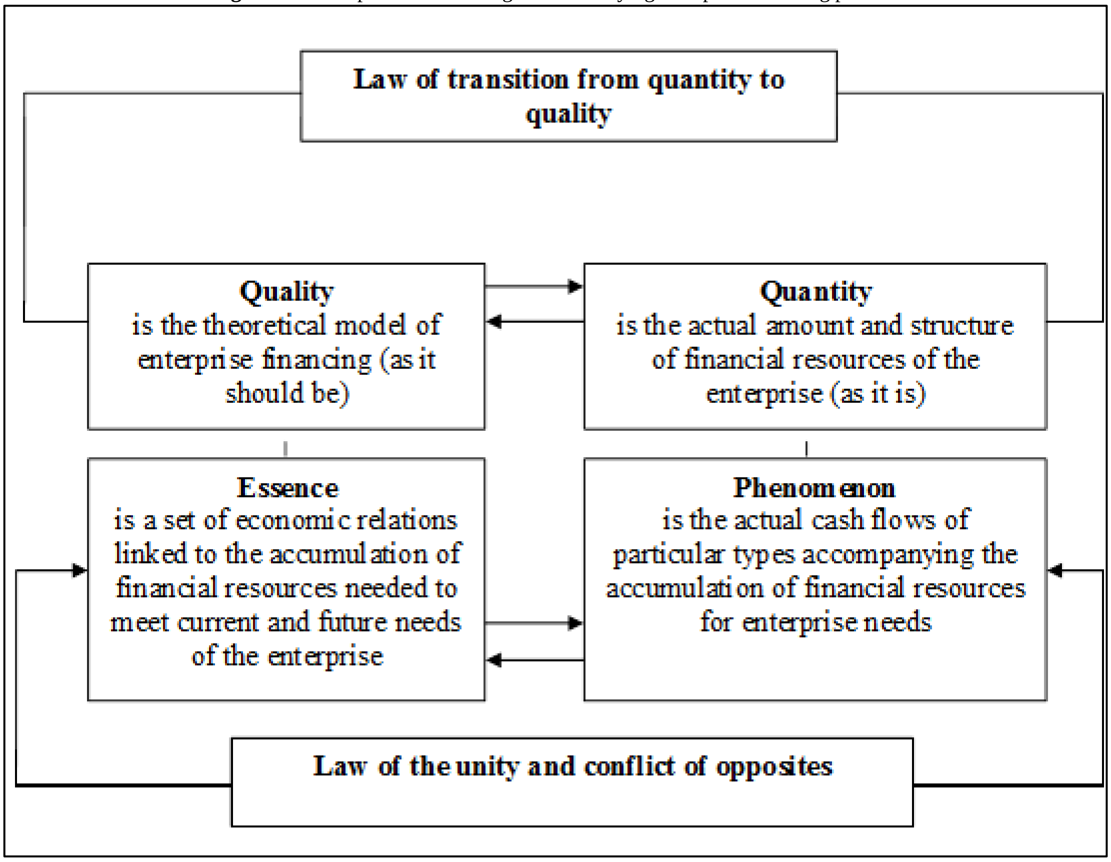
Practice shows that the enterprise financing structure as a phenomenon of reality is shaped by the three major categories, namely, quality, quantity, and measure. The law of transition from quantity to quality, and vice versa, is implied. The category of quality reflects such amount of financial resources that would fully meet the enterprise needs in covering current and capital expenditure to achieve its goals, while the category of quantity corresponds to the actually available amount of financial resources.

There exists a close relation between the quantitative and qualitative aspects of enterprise financing, as long as they are different, on the one hand, and can transform into one another, on the other hand. The quantitative characteristics of the enterprise financing model and its specifics reflect the category of quantity. Meanwhile, quality characterizes the ideal model of enterprise financing. Quality is transitioned into quantity as the limitations emerging in the formation of an actual enterprise financing model inevitably cause adjustments of its ideal.

The category of quality is closely linked to the category of essence, since quality characterizes the theoretical model of enterprise financing, while essence corresponds to the set of economic relations that shape it. Similar relation is observed between the categories of quantity and phenomenon (appearance), as the first category reflects the available amount of financial resources of the enterprise, while phenomenon corresponds to cash flows linked to their accumulation (Fig. 1).

The need to apply polar categories is due to the fact that it is impossible to outline the concept of enterprise financing other than by comparison of individual categories with the respective opposites.

Figure-1. Correspondence of categories in studying enterprise financing process



Given the idea of an ideal model enterprise financing is yet to be shaped, it is perceived to be a phenomenon of reality. Therefore, the process of enterprise financing is not separate from the phenomenon, but rather is its aspect and characteristic.

Obviously, financing of an enterprise should correspond to the general goals and objects of the latter and be implemented in line with the determined principles reflecting the specifics of the particular economic entity. In the authors' view, there is an assumption of a financing model built individually for each particular enterprise along the lines of implementation of its financial policy.

The financing strategy for enterprise operations can be singled out as a distinct component of the financial policy of the enterprise, which rests at the intersection of its issuing, investment, dividend, and asset and capital management policies. The financing strategy for enterprise operations is part of the general financial strategy and constitutes the process of forecasting, formation and optimization of the amount and structure of sources to finance operations with a view to use them efficiently and maintain financial stability of the enterprise. Meanwhile, the enterprise financing strategy is defined as the art of managing the sources and forms of financing by applying appropriate management technologies.

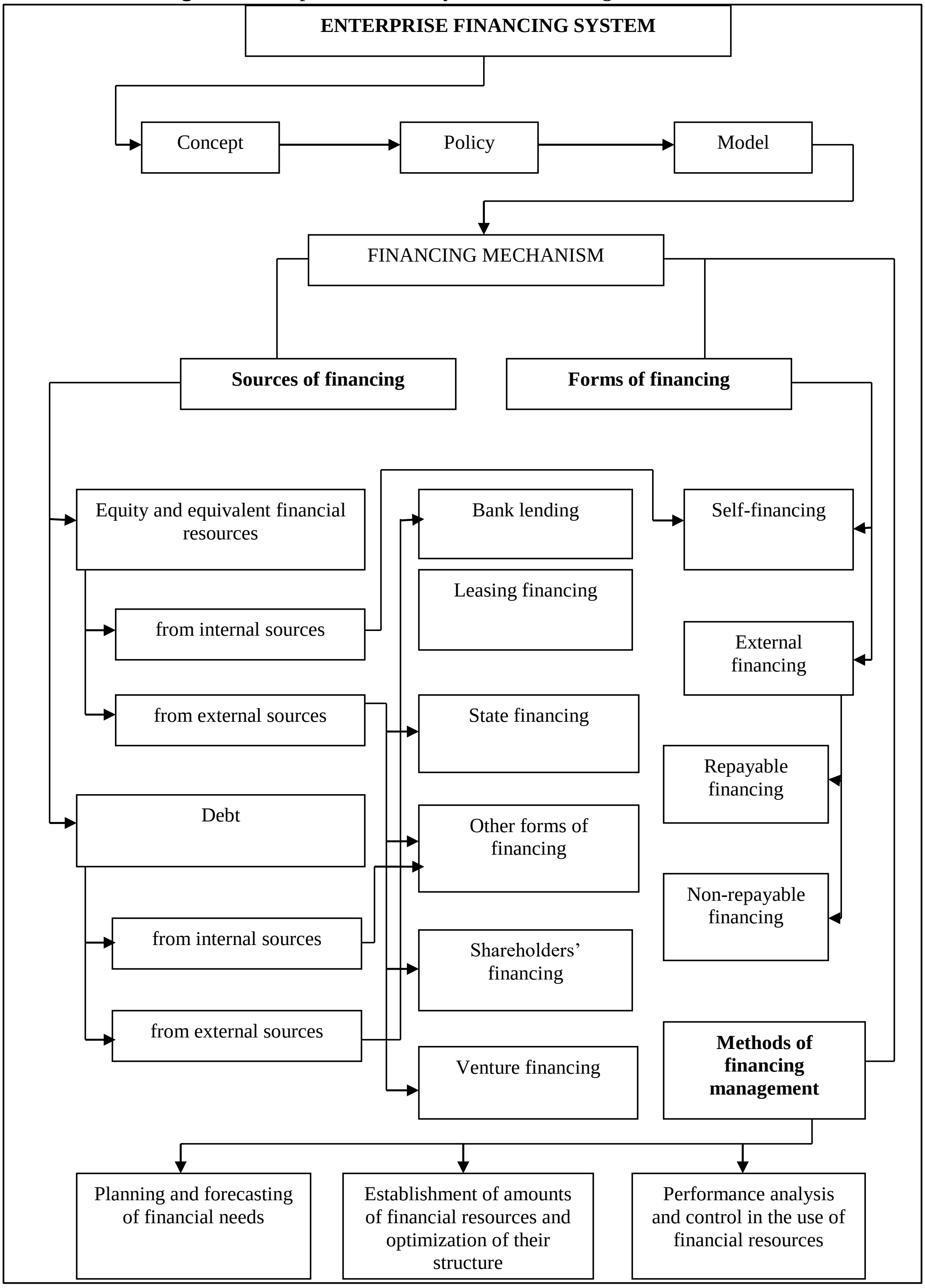
Therefore, enterprise financing is also reasonably addressed as a logically built structure of sources and forms of accumulation of financial resources and the methods to control their accumulation and use. Specific parameters of their use in establishing the required amount of financial resources for the economic entity can be determined along the way of implementation of the respective enterprise financing policy and the model developed from it (Fig. 2).

The sources of enterprise financing comprise equity and equivalent financial resources (authorized capital, retained earnings, proceeds from the issuance of equity securities) and debt in the form of bank loans, proceeds from the issuance of bonds, public budget loans, *etc*. The provision of financial resources to supply enterprise needs consists in the combination of self-financing with repayable and nonrepayable financing from external sources.

A specific form of enterprise financing is state funding, which can be in either repayable (public budget loan) or nonrepayable form (direct budget transfers, subsidies).

A particular formation model of sources and forms of enterprise financing is potentially shaped by many influences, particularly, enterprise income taxation specifics; rates and sustainability of sales growth; asset structure; state of capital markets; lending policies of commercial banks; level of management of financial resources.

Figure 2: Components of the system of financing and their interrelations



Also, a considerable influence on the structure of financial sources has the stage of the enterprise lifecycle, which corresponds to start-up financing, expansion financing, refinancing and rehabilitation financing.

4. Discussion

The reliability of the described approaches to improvement of enterprise financing system in an unstable economic environment is reinforced by that the selection of sources and forms of financing should rely on the use of a number of methods to manage this process (*i.e.*, planning and forecasting of financial needs, establishment and optimization of their amount, performance analysis and control of use) aimed at five key tasks, particularly, the evaluation of short- and long-term capital needs; identification and evaluation of potential changes in the setup of assets and capital to determine their optimal lineup and structure; sustainment of financial stability and solvency; maximum efficiency in the use of equity and debt; cutting costs in financing of operations (Kosevich *et al.*, 2016; Nikolskaya *et al.*, 2017; Zavalko *et al.*, 2017a).

Practice shows that the material carrier of enterprise financing relations is financial potential. At present, the financial potential of enterprises, in its core, comprises equity and equivalent financial resources, which characterize several forms of financing, namely, self-financing, shareholder financing, venture financing, etc. They are accumulated from both internal and external resources.

In most newly established enterprises, authorized capital plays the key role in the formation of financial resources, but its role becomes gradually diminished later on. Authorized capital appears as a source of financing to support enterprise operations only in the initial period of business, while later on, it only indicates the amount of contributed financial resources and should not be viewed as a source in addressing financial needs. Meanwhile, capital reserves are formed from contributions of profit remaining after compensating for all expenses and fulfillment of tax obligations. The purpose of capital reserves is to cover loss of the reporting period and pay dividends where profit for the reporting period is lacking or insufficient, *etc*. Therefore, it can be argued that the existence of capital reserves is a major condition for a stable financial position of the enterprise.

Apart from that, profit from operations plays a key role among the sources of internal financial resources of existing enterprises. Part of the profit can be channeled for rewards to employees and performance-linked bonuses, for maintaining social benefits, and the payment of dividends. Such profit is withdrawn from the economic cycle of the enterprise and should not be viewed as a source of financial resources. However, part of net profit may be used for increasing net assets, contributing to additional capital and capital reserves, for capital investment, and for compensating for retained losses of previous periods. In this case, it may be a driver of growth in the enterprise market value and a source of expanded reproduction.

Economic entities may independently decide on the appropriateness and parameters of profit distribution, as the current legal system leaves these issues at the discretion of the owners or their authorized bodies in accordance with the company statutes. The single aspect in the profit distribution procedure provided for by law is the replenishment of capital reserves; particularly, annual contributions to increase capital reserves should be no less that 5% of the net profit. This leads to unreasonable accumulation of retained profit by enterprises, and though such profit improves their financial position, this also poses a risk of insolvency and a fictitious bankruptcy event.

Depreciation charges for fixed and intangible assets involved in the economic cycle of the enterprise also play an important role in the formation of its financial resources. Depreciation charges make the main source of self-financing for an economic entity, as long as due to their relevantly low dependence on cyclical conditions of the enterprise operations and also due to the synchronization between the turnover of fixed assets and the depreciation charges, they are more acceptable in terms of maintaining the independence of its financial base.

5. Conclusion

In summarizing the above, it is worth noting that notwithstanding the positives of reliance on internal sources of financing, the efficient operation of an enterprise is impossible without debt. The use of debt helps to achieve significant expansion of operations, improved performance of equity, faster formation of special funds, and greater enterprise market value.

However, positive effects of borrowing only emerge when such borrowed funds are not captured in the business cycle for a long period and are repaid timely. Otherwise, overdue accounts payable emerge, which eventually leads to the application of fines and worsens the financial position of the enterprise. Meanwhile, modern financial theory and practice suggest there is the opportunity to use a wide range of internal and external sources of debt, being represented, for the most part, by bank loans, proceeds from bonds, accounts payable, state and private loans.

Borrowing cash for the economic needs of the enterprise leads to changes in the amount of its liabilities on the balance sheet. Efficiency of the use of debt significantly predicts the performance of financial management at the enterprise and shapes its competitiveness in the short and long term. In market conditions, debt is not only a source of covering the current capital needs of the enterprise, but also a powerful mechanism to financially maintain its development, expansion, and restructuring.

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