

Implementation of a New Preventive Financial Management Paradigm for Ukrainian Enterprises

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Based on the results of statistical analysis we highlight the crisis financial condition and factors of negative trends in the activities of Ukrainian enterprises. The necessity, timeliness, and the problems of implementation of the new for Ukrainian enterprises paradigm of preventive financial management is substantiated. The author’s view of the corporate finance, consequences of the crisis, the content of the crisis management and preventive financial management of enterprises is presented. The content and the role of the controlling as an innovative resource of the preventive financial management at an enterprise is determined.

Keywords: *corporate finance, new paradigm, crisis, crisis management, preventive financial management, financial controlling; risk controlling*

Introduction

The fundamental principles of the financial management of enterprises at the current stage of development of the world economy significant changed. The innovative development and integration of the economy of Ukraine into the global economy require a revision of current concepts of financial management of businesses. Market globalization became the cause of increased risks and of the number of financially insolvent enterprises.

The aim of this research is justification of necessity, timeliness and the problems of implementation of the preventive financial management paradigm a new for many businesses in Ukraine.

We disagree with the standpoint that the definition of «corporate

finance» applies only to finances corporations or finances of joint stock companies, and support the opinion [1] that the theory of corporate finance applies also to “... finance of the companies of different legal forms of ownership: from small businesses to large.”

In the English economic literature the term “corporate finance” many reputable authors [2-7] use as synonym for “financial management of the firm.” The author of this article (in her works) defines the term “corporate finance” as a synonym for “finance of subjects of business (companies),” which is the object of management under modern conditions of macroeconomic instability. The management personnel, employees of the financial departments, including Controlling enterprise services, are the subjects of management by corporate finance.

Research results

The consequences of the global financial crisis, limited financial resources and the strong competition have led to a significant deterioration in performance and catastrophic increase in debts and losses of Ukrainian enterprises. The dynamics of the financial results of the enterprises in Ukraine for 2001-2011 years (based on the data from the State Statistics Service of Ukraine [9]) is presented in Fig. 1.

According to statistical research performed by the author, since 2007 there has been an annual decrease of the profit of Ukrainian enterprises. Based on the 2009 data, the value of expenses exceeds the income by UAH 42,414.7 millions, which resulted in unprofitableness of domestic enterprises. Though the revenue in the year 2010 exceeded the expenses, but the profitability was much lower than in 2007, before the global financial crisis.

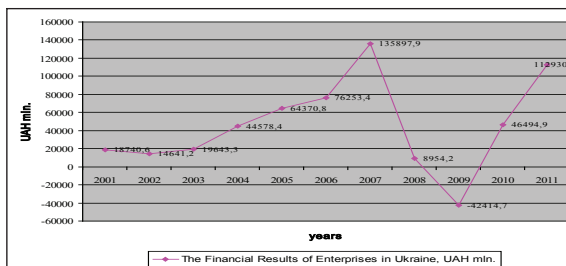


Figure 1: The financial results from ordinary activities before tax of enterprises in Ukraine for 2001-2011 years (UAH millions) (Source: made by the author on a basis of [9])

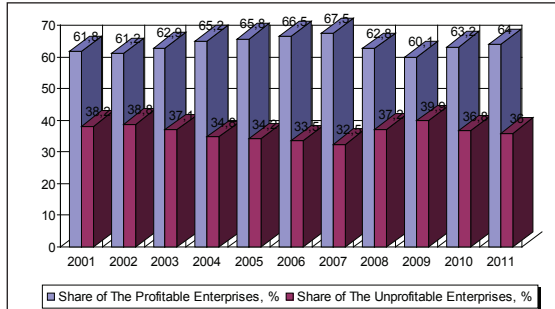


Figure 2: The share of unprofitable and profitable enterprises in Ukraine during the period 2001-2011 years (Source: made by the author on a basis of [9])

Figure 2 represents the dynamics of the share of unprofitable enterprises in Ukraine in 2001-2011 years. The analysis of the proportion of unprofitable and profitable enterprises confirms the negative trend of worsening financial condition of domestic enterprises. Since 2007 there was a decrease in the share of profitable enterprises from 67.5% of total enterprises in 2007 to 59% in 2010, and, as the consequence, an increase of the proportion of loss-making enterprises from 32.5% to 41% respectively. The percentage of profitable enterprises somewhat increased in 2011 year, but this index remains lower than in the pre-crisis 2007 year.

Table 1: The Share of Own Capital, Liabilities, Receivables in the structure of resources of enterprises in Ukraine during the period 1.01.2008-1.01.2011 years (Source: calculated and made by the author on a basis of [9])

date	Total Assets, UAH mln	Own Capital		Long term Liabilities		Current Liabilities		Receivables	
		UAH mln	%%	UAH mln	%%	UAH mln	%%	UAH mln	%%
1.01.2008	2441101,9	1029775,5	42,18	349791,2	14,33	992270,1	40,65	692205,2	28,36
1.01.2009	3169685,3	1169966,7	36,91	560042,5	17,67	1352935,8	42,68	954606,0	30,12
1.01.2010	3493792,0	1252279,0	35,84	592910,8	16,97	1556970,3	44,56	1106143,6	31,66
1.01.2011	2832451,3	976116,8	34,46	473758,1	16,73	1298257,1	45,84	935925,8	33,04

As it is demonstrated in Tab.1 and Fig.3, during the last four years

(also in the post-crisis period) the share of the own capital in the structure of enterprise resources in Ukraine was rapidly decreasing and the proportion of accounts receivable and creditor debts was increasing. It should be noted that the share of the own capital on 1.01.2011 was only 34.46% indicating the unstable financial state of the majority of Ukrainian enterprises and inefficient management of them.

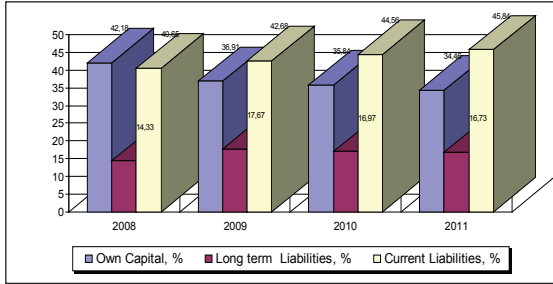


Figure 3: Dynamics of Shares of Own Capital, Long-term Liabilities and Current Liabilities in the structure of resources of enterprises in Ukraine during the period 1.01.2008-1.01.2011 years (Source: made by the author on a basis of Table 1)

It should also be noted that more than a half of own capital of the enterprises as on 1.01.2011 had been formed due to upward revaluation of non-current assets, that is was not accompanied by a real inflows of cash. At the same time, profit was only 1.34% of own capital and could not provide sufficient pace of expanded reproduction (Fig. 4).

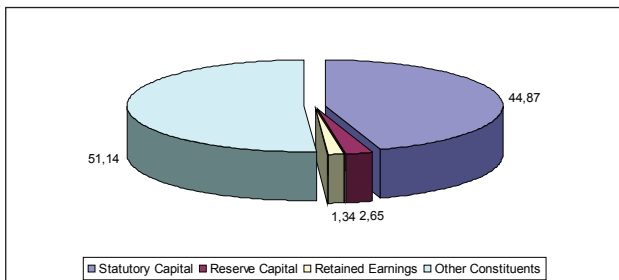


Figure 4: Own Capital Structure of Enterprises in Ukraine as of 1 January 2011 year (calculated and constructed by the author based on [9])

The negative tendencies in the enterprise’s activities have internal

and external causes. Enterprises can not prevent and avoid the influence of such external factors as financial crisis, reducing demand, currency fluctuations, imperfect legislation and so on. These factors negatively affect the activity of business entities and can lead to bankruptcy. However, correct and timely management decisions can reduce the negative impact of external factors. Timely implementation of preventive measures based on the financial diagnostics play a key role in making effective financial decisions by management personnel.

The internal causes of the crisis on the domestic enterprises are: the high cost price, obsolete equipment and facilities, significant accounts payables and receivables, shortage of current capital, inefficient marketing, conflicts of interest between the participants of the financial and economic relations and so on. All these factors are the result of inefficient management which untimely implements the appropriate preventive measures.

The national business entities must be able to resist to the risks of market globalization. This should occur due to the timely implementation of preventive anti-crisis measures at the domestic enterprises. The growing risks in international financial and commodity markets necessitates developing of foundations of the implementation of a new scientific paradigm in crisis management of the enterprises in the concept (framework) of a preventive management. The choice the adequate effective preventive measures in the enterprise is a complicated scientific task. Solving this problem involves the development and implementation of a new paradigm of preventive financial management.

As a result of the reforms and the emergence of problematic situations in the theory and practice of social and economic processes is the transformation of methods for solving of complex economic, political, social and other problems by various researchers. The necessity of development of a new or upgrading of an existing paradigm arises. Statistical analysis reveals that many domestic Ukrainian companies are in a deep financial crisis, this is why the renewal of the paradigm of financial management is problem of today.

However the term “crisis” does not always contain negative content. Ukrainian researchers [10, 11] note also some positive effects of a crisis, since every crisis contains certain potential. The crisis not only destroys but also creates new opportunities for development. The risk of a crisis exists in conditions of stable economy, so that any enterprise may find itself in critical

situation. In many cases a crisis gives an opportunity to prepare the company to reach a qualitatively new level, progress, the mastery of a new market segments etc.

Going out of a crisis is often a result of consistent and coordinated actions, to a big degree owing to an efficient preventive management. A preventive management must timely recognize the crisis and take appropriate improving actions to prevent the devastating effects of the crisis and to provide the foundation for future business growth. The current state of corporate finance in Ukraine justifies the top priority importance of a preventive crisis management and financial controlling instruments to ensure the management systems by the necessary information.

Controlling is determined by domestic scholars as a systemic informational and innovative resource which is oriented on the future [12]. Innovative development of enterprises and the integration of the economy of Ukraine into the world economy requires analytical dynamic information that reflects the intensity of the usage of economic resources and the efficiency of the subdivisions in order to optimize costs and minimize losses. Using Controlling instruments is a prerequisite for the transformation of Ukrainian enterprises into innovative economic systems.

The results of the research allow us to formulate the following conclusions regarding the definition of the financial controlling and preventive financial management contents.

Financial controlling - is the activity of obtaining information for systematization and use in adoption of effective management decisions. The Financial Controlling uses such tools as accounting, auditing, financial diagnostics, planning, budgeting and more. Controlling aimed at functional support of a crisis management. The tight integration conceptions of a controlling and a crisis management must be provided.

Crisis management is a management system that provides application of specific managerial, financial and organizational methods and tools. Using these techniques and instruments aimed at prevention or overcoming crisis situations in the company.

The Crisis financial controlling is an imperative for a crisis management, the element that controls, restrains and reduces the manifestations of the risks in the enterprise's functioning.

We discern two approaches to determining the content of a crisis management, which are dominant in Ukrainian financial science. Reference

book [13] interprets the crisis management as an activity management firms to overcome critical problems enterprises that have accumulated as a result of “bad” management. This definition ignores the necessity to introduce of the preventive measures system at the enterprises. The majority of Ukrainian scientists and economists [10, 12, 14-17] support the second approach to understanding the content of crisis management. They define crisis management as one focused to the output of an entity off a crisis state as well as oriented on prevention of insolvency of the enterprises on the basis of developed strategic programs.

The author considers the meaning of crisis management as the implementation of complex measures on prevention and neutralization crisis on the stages of revealing crisis factors on the base of early diagnostics, aimed at implementing the strategy and further development of the company, and, in case of violation of financial equilibrium, at helping an enterprise to get out off the crisis situation. The main purpose of crisis management is to ensure sustainable functioning of the enterprise due to timely respond to changes in the external and internal environments of the functioning of the company.

We believe that the preventive management paradigm should be the basis of corporate finance management in modern conditions of high-risk activities of business entities. Therefore, the definitions of “crisis financial management” and “preventive financial management” offer to use as synonyms towards enterprises that are not in the crisis.

Risk Controlling is an important part of preventive management, because the risks are the factors of the crisis at the company. Crisis Controlling should necessarily include Risk Controlling, because the Risk Management in the company is able to not only manage risk at the time of its occurrence but also to reduce possible losses and related negative consequences. Risk Management is able also to develop measures to neutralization risks. This leads to a decrease of the probability of a crisis and bankruptcy of enterprise, and hence to improving the efficiency of enterprise management.

It should be noted that controlling is being gradually introduced in the large and medium-sized Ukrainian companies. However, there are problems of implementing of crisis financial controlling in the Ukraine: organizational (lack of corporate culture), resources (shortage of funding and deficit of economic knowledge managers), psychological (skeptical perception of financial controlling by managers), and methodological (non-availability: unified normative, legal and methodological foundations of corporate

standards controlling) and others.

Controlling promotes a partial solution of the problems of the agency relations (principal-agent conflicts) and asymmetric information. Publications [4-6, 18] are devoted to determining ways of resolution of conflict of interest and problems of asymmetric information. In particular, Peter Atrill notes that corporate governance leads always an agency problem, which examines agency theory [6].

The problems of agency relations highlighted in modern Ukrainian economic literature [12, 19, 20]. However, the problems of conflicts of interest and asymmetric information in Ukraine require a more fundamental research by scientists in the corporate finance sphere.

The current legislation must also favour the implementation of preventive financial management paradigm on the enterprises of Ukraine. Transformation of normative and legal regulation restoring solvency subjects of business that took place in connection with the adoption of a new bankruptcy law (will come into effect January 18, 2013) is an example of understanding of timeliness of implementing innovative paradigm of crisis management and corporate finance rehabilitation by public institutions. The Law of Ukraine "On Restoring the debtor's solvency or recognition his bankruptcy" in the new edition is a progressive innovative product in sphere of economic law that regulates financial relations in the process of Crisis Finance Management, restoring in solvency and liquidation of business entities. The author's research has led to the conclusion that the new law favors the most possible satisfaction of claims of creditors and a financial recovery of the companies which have temporarily got in a tight situation.

Conclusions

The results of research of necessity, problems and ways of introduction of a new preventive financial management paradigm for the Ukrainian enterprises lead to the following conclusions:

- The revision of current conceptions of financial management businesses is actualized in the present conditions of dynamic changes, increased competition and financial risks in the economy.
- The indicators of performance, in particular, the debts and unprofitableness of enterprises in Ukraine have deteriorated significantly after 2007. The dynamics and the structure of own capital firms are unsatisfactory.

The share of own capital in the sources of funds at the level of 34.46% indicates the precarious financial situation and inefficient management in most of enterprises in Ukraine.

- The influence of the global financial crisis, the reduced demand, currency fluctuations, imperfect legislation, etc. are the external factors of negative trends in activity of enterprises. The high cost price of the product and the reduced demand for it, obsolete fixed assets, a significant payables and receivables, lack of working capital, conflicts of interest, inefficient management, lack of financial controlling and preventive management are an internal causes of the crisis on domestic enterprises.

- The growth of risks in international financial and commodity markets stipulates the necessity of implementation of a new scientific paradigm of a crisis management of enterprises in the concept of preventive financial management. The choice of adequate effective preventive measures in the enterprise is a difficult complex scientific task.

- The current state of enterprises in Ukraine determines the primary importance of a crisis preventive management and financial controlling tools. An innovative development of enterprises and the integration of Ukraine in the world economy makes the dynamic analytical information a top priority task. Such information must reflect the intensity of use of economic resources and the performance of the subdivisions in order to optimize costs and minimize losses. It actualizes the introduction of the controlling on the enterprises.

- The content of a crisis management is the implementation of a complex of measures on prevention and neutralization of crisis on stage of detection crisis factors based on the results of timely diagnostics, aimed at implementing the strategy and further development of the company, but in case of a violation of financial equilibrium - at helping an enterprise to recover from the crisis situation. The preventive management paradigm should become the basis of management by corporate finance in the modern conditions of high-risk activities of business entities. The definitions of “crisis financial management” and “preventive financial management” are advisable to be used as the synonyms.

- The problematics of principal-agent conflicts and asymmetric information require more fundamental researches by the Ukrainian scientists.

- We ascertain the gradual perception of the innovative for the Ukrainian socium paradigm of preventive financial management in the fields of science, law and business entities management practice.

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