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Formation of A Strategy of Industrial Enterprise Financing With the aim of Profitability Increase

ABSTRACT

The paper refers to nature and the necessity of a strategic approach to financing in the industry. The author considers reasons and characteristics of an industrial enterprise financial strategy under contemporary complicated economic conditions. A methodology of selection of the most sufficient financial strategy for an industrial enterprise in the process of corporate financing is suggested. The independence of industrial enterprises, their economic and legal responsibility regarding activity results forms in terms of the Ukrainian economy development under the current economic conditions. The significance of industrial enterprise financial stability increases dramatically. This causes an objective need to determine tendencies of the dynamic formation of their financial position and prospective financial opportunities. An industrial enterprise financial strategy, as a system of prospective purposes of a financial and economic activity and the choice of the most effective methods and ways of their achievement, focuses on the solution of the determined above issues. The formation of a proper strategy of industrial enterprises financing with the aim of the enterprise profitability increase is provided by: the possibility of modeling a financial and economic situation; to detect and prognosticate the necessity of strategic modifications; to apply powerful and reliable instruments and a methodology; to implement the constructed industrial enterprise financial strategy in order to receive planned and desirable activity results.

All possible types of the financial and economic strategy of industrial enterprises may be represented in the form of a matrix of a financial and economic strategy of an enterprise. Strategic analysis within the suggested matrix enables to consider the problem in dynamics. Moreover, it also makes possible not only to formulate a financial strategy, but also to change it operatively as a result of dynamic changes of certain targeted sufficient parameters of an industrial enterprise activity.

A strategic directive in the industrial enterprise activity generally stipulates its financial strategy of providing the profitability. Thus, the correlation between them is much stronger than a cause and effect relation, as it may be suggested in the process of cursory examination. An industrial enterprise financial strategy is independent to a certain extant compared with an industrial enterprise general strategy. During the creation and implementation of a financial strategy the industrial enterprise is more independent than during the process of implementation of its general strategic direction of an activity.

Also this paper focuses on the development of recommendations concerning the consideration of the determined problem in dynamics. This enables not only to formulate a financial strategy of profit gaining, but also to modify (change) it as a result of the modification of many important parameters of industrial enterprise functioning.

Key words: *profit, strategy, financial strategy, strategic advantage, financial activity.*

Introduction. Under market conditions, where each enterprise responses for results of its activity, it is important to determine tendencies and assess a financial position in order to be aware of methods and conditions of doing business. The solution of the above determined issues is provided by the financial strategy of industrial enterprise financing. A general strategic position of an enterprise determines its financial strategy. However, as considered below, this relation is more complicated than just a simple cause and effect one.

The problems of industrial enterprise financing strategy formation with the aim of profitability increase were researched in scientific papers of the following famous scientists and economists: I. O. Blank, O. D. Vasylyk, O. P. Kyrylenko, V. V. Kovaliov, E. S. Stoianova, T. V. Teplova etc. The significant input in the study and development of the financial strategy formation issues regarding the profitability increase was made by Ukrainian and foreign authors: A. Babo, L. Bernstein, I. Blank, Y. Boiko, R. Braily, E. Birghem, O. Vasylyk, S. Golov, M. Korobov, S.M. Mayers, K. Marks, F. Night, E. Nickbacht, V. Oparin, O. Orlov, A. Peresada, K. Pavliuk, G. Piatachenko, D. Ricardo, S. Rossa, E. Riasnyh, P. Samuelson, A. Smith, E. Stoianova, Y., Y. Subbotovich, V. Sutormina, E. Helfert, V. Chumachenko, J. Schumpeter, etc.

Nevertheless, some issues related to peculiarities of industrial enterprises financing with the aim of profitability increase under crisis conditions remain unsolved. Considering a high level of the market conjuncture uncertainty and its permanent changes, methods of the strategy formation (including profit) must be flexible. This enables to make modifications and to forecast consequences of influence of these factors on enterprise business activity indexes. To achieve this aim, it is necessary to apply in the practice the methods of planning and operational analysis, including its main instruments – marginal profit, a financial strategy matrix etc.

Results of The Research (Paper Main Body). The most important issue of the financial mechanism of industrial enterprise functioning refers to the formation of a responsible and efficient financial strategy. An industrial enterprise financial strategy is considered as complex management of all assets, liabilities, and shareholders' equity of an enterprise.

V. P. Maslovskii and V. N. Surai, considering an enterprise strategy, emphasize a strategy oriented on the profit maximization in a short-term period (periods) and a strategy oriented on the fixation in an own market segment and its extension even at the expense of profit decrease in a short-term period *(Maslovskii & Surai, 2000, 32).*

We suggest that there is not only a direct relation "enterprise strategy – enterprise financial strategy", but also an inverse one: "enterprise

financial strategy – enterprise strategy". Therefore, an enterprise financial strategy is independent to a certain extant compared with the enterprise strategy itself. Thus, an entrepreneur has more freedom in the enterprise strategy formation than in the process of the formation of a general strategy policy of enterprise behavior.

All possible types of an industrial enterprise financial strategy may be represented in the form of a firm financial strategy matrix. Making certain manipulations within the matrix, we can consider the problem in dynamics, enabling not only to formulate a financial strategy, but also to modify (change) it as a result of the verification of certain important parameters of enterprise functioning.

To study the given matrix we should use several categories of financial management (Blank, 1996, 534):

1) BAR – business activity results:

$$BAR = BREI - P_1 - P_2 + P_3 \tag{1}$$

where $BREI$ a gross result of the investment exploitation. According to economic nature BREI is considered as profit before counting off amortization, financial expenses for credit funds, and profit taxes;

P_1 – a change financial and exploitation requirements;
P_2 – production investments;
P_3 – current property sales.

2. FAR – financial activity results:

$$FAR = L_1 - L_2 - T - (D + OE) \tag{2}$$

where L_1 – a change of borrowed resources;
L_2 – financial expenses for borrowed resources;
T – a profit tax;
D – dividends;
OE – other expenses and financial activity expenses.

3. FBAR – financial and business activity results.

$$FBAR = FAR + BAR \tag{3}$$

From the standpoint of the economy, the business activity result may be determined as enterprise financial resources after development financing. BAR indicates the enterprise liquidity after financing all expenses related to its development. The positive value of this figure enables to begin the process of implementation of large investment projects (an enterprise is ready to face dramatic increase of fixed expenses, which may be compensated by the positive value of BAR).

S. V. Lukachov, A. M. Lanskiy, and D. E. Pashkov suggest that a financial activity result explains an enterprise financial policy (involvement of the borrowed resources or functioning without them) *(Lukachov, Lanskiy, & Pashkov, 2001, 240)*. Calculating a financial result, we take into consideration only the financial flow movement. The decisive factor of the FAR index calculation is the variance of borrowed resources. In the process of increase of borrowed resources use the FAR index grows up and becomes positive. In the process of increase of expenses related to the borrowed resources repayment, the FAR index decreases (that is also impacted by the profit tax increase, because the increase of borrowed resources put into action the financial leverage, which influences the enterprise revenue, its profit and dividend payments).

The enterprise is obliged to reduce the use of borrowed resources. Nevertheless, the above mentioned «chain» changes its direction. This enables to increase an amount of the borrowed resources.

The previously explained mechanism of the FAR change is brilliantly implemented in a life cycle of an industrial enterprise, complements it, and approves its reality and objectivity. Thus, in the phase of the borrowed resources involvement the FAR index becomes positive, while in the phase of abandonment from the borrowed resources the FAR index gains the negative value.

The BAR index is used to disclose values and dynamics of enterprise financial resources as a result of its investment and business activity. FAR is applied to determine values and dynamics of the enterprise resources as a result if its financial activity. Therefore, FBAR explains value and dynamics of entity financial resources after the performance of a whole complex of investment, productive and financial activities of an industrial enterprise. Positive value of a financial and business activity result enables to affirm that an industrial enterprise activity is characterized by the excess of revenues over expenses, and this conclusion can be applied not only to a current period, but also to a whole short-term period.

L. A. Kostyrko suggests that it is important for a firm to have the positive value of FBAR *(Kostyrko, 2002, 560)*. It is obviously that a life cycle of an industrial enterprise does not enable to affirm that the industrial enterprise can always have such a value of the FBAR index (for instance, in a period of the investment project implementation with the required growth of fixed expenses and the profit decrease).

The FBAR dynamics perfectly fits to the determined life cycle of an industrial enterprise. A period of the negative FBAR value follows a period of positive FBAR changes and so on under conditions of normal enterprise development. An industrial enterprise can't show off the negative FBAR index for a long time period. It is a risk of bankruptcy. Thus, it is important to apply a concept of the balanced FBAR considered within an enterprise life cycle (at least one). FBAR of a normally functioning industrial enterprise may vary during a life cycle between 0% and 10% of the added value (in both directions). It's a safe zone for the enterprise.

A financial manager is supposed to manage a financial and business activity of an industrial enterprise in a way enabling not to overstep limits of this zone. Low-amplitude fluctuations are a perfect variant. This information should be reminded even in a period of significant investments (BAR plummets and "takes" FBAR in the negative direction) and a period of a sufficient level of profitability and the financial resistance growth (a period of the FAR slump and its transformation into the negative value alongside with the FBAR value follows the FAR growth).

The previously described data enable to notice asynchronous behaviors of the FAR and the BAR indices within a life cycle of an industrial

enterprise. Furthermore, this asynchrony is strengthened, because it does not coincide with cycle fluctuations of the industrial enterprise production. For example, FAR slides in a period of attaining the high value of the financial strength surplus. At the same time, we are before a period of the increase of sharp fixed expenses as a result of the investment project implementation. Consequently, we may conclude that an expected optimal algorithm of FAR and BAR of an enterprise (within FBAR) (whether it is important to attain the synchronous change of FAR and BAR) is unattainable without dynamics turnover (revenue) loss.

The matrix of financial strategies enables to solve the most of the above determined problems (as a result of the FBAR optimal value attainment).

Figures of this matrix were recommended by French scientists J. Franshon and I. Romani.

	FAR << 0	FAR = 0	FAR >> 0
BAR >> 0	FBAR = 0 1	FBAR > 0 4	FBAR >> 0 8
BAR = 0	FBAR < 0 7	FBAR = 0 2	FBAR > 0 5
BAR << 0	FBAR << 0 9	FBAR < 0 6	FBAR = 0 3

The 4, 8 and 5 quadrants are related to the accumulation of enterprise liquid resources (certain surplus of current assets). The 7, 6 and 9 quadrants are related to the consumption of industrial enterprise liquid resources (the current assets deficit).

FAR is horizontally related to the growth of enterprise borrowed resources. We move from the negative value of the FAR to the positive one.

FAR is vertically related to the enterprise investment project implementation (mass fund investing). This is the only explanation of the turnover from the positive FAR value (the brilliant possibility to start the investment project implementation) to the negative one (a situation of significant financial investing).

We should now analyze each of the possible states (1-9) and those types of the financial strategy, which may be applied by an industrial enterprise.

We should begin from the first square. It is characterized by the state, when the FBAR index is close to zero (FAR and BAR stand in some kind of the opposite phases). There are, at least, three possible variants of the financial development: a) shift to the quadrant 4, b) shift to the quadrant 7, c) shift to the quadrant 2. We should consider all the possible scenarios.

Firstly, staying in the quadrant 1, the enterprise has enough possibilities to start the investment project implementation (BAR >> 0). On the other hand, from the financial standpoint the given enterprise stay in the phase of abandonment from the involvement of borrowed resources, when financial expenses, related to the current indebtedness repayment, grow as well as profit tax spending and dividend expenditures increase (financial strength of the enterprise is enough high). That is to say, from the financial standpoint such enterprise deals with the necessity of the financial project implementation.

Nevertheless, the enterprise still keeps the possibility to increase its financial strength at the expense of the financial leverage effect mobilization. This enables to keep production increase rates, which leads to the 4th quadrant shift.

But the most appropriate scenario related to the investment project implementation is the turn to the quadrant 2 or 7 (depending on the turnover growth rate). With the higher growth rates it shifts to the quadrant 2. With the lower growth rates the enterprise shifts to the quadrant 7.

Now we should consider the enterprise, which stands in the quadrant 2. Functioning under such conditions, the enterprise stays in a financial equilibrium position (in the dynamic change of unequal states a situation, in which almost-zero value of FAR and BAR are close to zero, is possible).

A business activity of the enterprise can "shift" it to one of the six quadrants – a number of freedom degrees (non-equilibrium types) for the enterprise being in the equilibrium state is higher than for the enterprise being in an unequal position with positive or negative value. As a result of the certain activity performance, the enterprise may shift to the quadrants 1, 4, 7, 5, 3, 6.

As a result of the investment project implementation (depending on the production growth rate) the enterprise may transfer to the quadrant 6 (the low growth rates) and the quadrant 7 (the sufficient growth rate).

Depending on the made decision in the field of the borrowed resource usage, the enterprise may shift to the quadrant 5 (the borrowed resource exploitation increase and the active appliance of the financial leverage effect) or to the quadrant 7 (abandonment from the use of the borrowed resources and weakening of the financial leverage influence).

With the reduction of the financial and exploitation expenses the enterprise may shift to the quadrant 4 (with the sufficient growth rate) or the quadrant 1 (with the temperate growth rate of the turnover).

The enterprise is disposed in the quadrant 3. Such enterprise is characterized by the opposite phase of FAR and BAR, but this time – with the opposite sign (compared with the quadrant 1). The negative BAR value indicates that the enterprise has either implemented the business project or reduced financial and exploitation needs (on account of the creditor indebtedness growth). A possible scenario of the development – the shift to the quadrants 5 or 6 (return to the quadrant 2 is scarcely probable – only in a case of the equilibrium of the turnover growth rate and the profitability). The shift to the quadrant 5 is possible under conditions of the increase of enterprise financial and exploitation needs. In this case the enterprise asset profitability increases and the turnover (revenue) growth rate rises.

In case of the decrease of borrowed resources in the form of the loan (a financial leverage influence weaknesses), the enterprise may be transferred to the quadrant 6, that is explained by the own financial resources growth.

The 4th quadrant is characterized with the FBAR positive value. The enterprise owns enough resources to implement investment project

with the zero value of FAR. There is also certain surplus of liquid resources. A possible scenario of the development is the shift to the quadrants 1, 2, 7.

The enterprise shifts to the 2nd and the 7th quadrants in case of the investment project implementation. If the growth rate is high enough, the enterprise shifts to the quadrant 2. With the low turnover growth rate it shifts to the quadrant 7. In this case the borrowings related to the investment project implementation will negatively influence the FAR value. But it will cause the necessity to take responsible decisions, as the enterprise can shift from the determined position to both the position with wide range of opportunities for the enterprise and the position of the enterprise financial state deterioration.

In case of the borrowed resource usage decrease the industrial enterprise may shift to the position 1. The influence of the financial leverage in this quadrant decreases as well as the profitability of the own resources slightly goes down.

The next position is the quadrant 5. On the whole, the enterprise position is enough good, stable (the same as in the 4th quadrant), with the surplus of liquid resources; the enterprise has the possibility not only to fix in the own segment, but also to extend it on account of the diversified production. In case of the high profitability level and the growth of financial payments related to the production increase the enterprise can shift to the quadrant 2, but this is the equilibrium of a diversified and increasing enterprise. This enterprise has good prospects in the future.

With the economic profitability decrease this enterprise can deteriorate its position and shift to the 6th quadrant. But it is worth mentioning that the determined position refers also to the enterprise with diversified structure. The managers must decide, what is more important for the enterprise: a diversified structure or the sharply negative value of FAR. The choice is difficult, but important.

The enterprise is disposed in the 6th quadrant. The FBAR index is below zero on account of the highly negative value of the BAR index. Maybe, the enterprise has either just implemented the investment project or performed the diversification of its production (activity). There is an insignificant deficit of the liquid funds.

There are three possible scenarios of the development– the quadrants 2, 7 or 9.

The best prospective is to renew the equilibrium (to return to the quadrant 2; but this action requires accurate and urgent measures). The profitability of the assets must be recovered to the appropriate value (the efficiency will be recovered due to the reduction of expenses at the enterprise). If it's possible, the financial and exploitation expenses must be reduced at the expense of effective management of the debtor and creditor indebtedness of the enterprise.

The shift to the quadrant 7 seems to be more possible. This transfer may be performed on account of the borrowed resources usage reduction due to application of the previously determined steps. In this case the situation with the enterprise liquid resources will not be improved, but the crisis factors will be transformed to the other form, which can shorten the time for overcoming this state.

The quadrant 7. The enterprise faces the liquid funds deficit. The most possible reason is the asynchrony of their incoming and consumption. That is why the situation is controlled. The enterprise can shift to the position 2 or 1 if the situation of the economic profitability growth (faster than the turnover growth) is attained. This means that the crisis overcomes. To attain such situation the business activity of the enterprise must be sharply rationalized (managers should pay special attention to ordering the fixed expenses, which enables to mobilize the operational leverage). The possibilities of both the debtor and the creditor indebtedness manipulations must also be considered.

In case, when the economic profitability does not grow up or decreases, the most possible scenario is crisis deepening (the shift to the quadrant 9, possibly through the position 6 (however, nor this, neither other scenario ensures demandable results in the given circumstances).

The next position is directly opposite to the previous two – the quadrant 8.

In such circumstances the enterprise has apparently expressed surplus of the liquid resources. If the enterprise is able to manage it efficiently, the position may become more stable. It must be highlighted, that we didn't manage to transfer to the quadrant 8 with the traditional shift from any other quadrant. It means that the given position is related not only to the success in the fields of finance and production. In this quadrant the economic success of the enterprise must be supported by the success in founding and the branched firm structure creation.

The second opportunity refers to the shift to the 5th quadrant by the decrease of the parent company market through the demand reduction for its products. The business activity result (BAR) should be given up on account of the financial and exploitation expenses increase, which are to be faced in case of the enterprise external environment change.

The 9th quadrant. This is a real crisis state of the enterprise. Suggested advices of overcoming the crisis are the following ones: disinvestments, financial support of government (if possible) or parent company (if it does exist), enterprise division (provides the fixed expense reduction and the decrease of financial and exploitation demand).

As a result of the application of the above determined steps, the enterprise can shift to the 7th or the 6th quadrant.

Therefore, all the matrix quadrants are considered. The shift from one to another quadrant of the given matrix enables to analyze the firm strategy in dynamics. There are many possible scenarios, but if the position of the firm within the quadrants of the matrix is accurately identified, the number of the possible variants is restrained.

Summary. The financial strategy matrix may be very useful for domestic industrial enterprises. Nowadays, domestic industrial enterprises exist in the circumstances determined in the quadrants 6, 7, 9. All of them are characterized by the enterprise liquid funds deficit. Under conditions of the tough monetary macroeconomic government policy the problems regarding the current funds seem to be quite predictable. It is worth mentioning that the reality gives very interesting (non-traditional) forms of such deficit cover. They encompass the use of ersatz-money and the practice of non-payments. Taking into consideration such means of the liquid funds deficit cover, it may be accepted that the placement of industrial enterprises in the 6th and the 7th quadrants is not a crisis indicator, but quite an opposite one – an indicator of certain stability in objectively existing circumstances of the external environment.

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