

PRINCIPLES OF FINANCIAL MANAGEMENT IN UKRAINIAN AGRIBUSINESS COMPANIES

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Abstract. The goal of the research is to study current practices of financial management in Ukrainian companies from agribusiness sector. Ukrainian managers applied a multidimensional approach in financial management oriented on such goals as sustainable growth, continuity and maximizing profits. A great importance of control, analysis and reporting in financial management derived from a need for detailed financial information for board and shareholders as well as for Ukrainian tax authorities and other governmental bodies. Efficient working capital management was a necessary condition for continuity of operations in highly volatile Ukrainian market. The most preferable capital budgeting technique was profitability index, while net present value and internal rate of return were less popular. Ukrainian managers were strongly supporting the pecking-order theory of capital structure.

Key words: financial management, capital budgeting, capital structure, agribusiness

INTRODUCTION

Corporate financial strategy has a great impact on a company's value. It is formed according to principles of corporate finance and realized by managers in a process of financial management basing on various methods and techniques. Quality of this process largely depends on different factors such as size and financial condition of a company, phase of a business cycle, availability of financing as well overall macroeconomic and political situation. Nevertheless, the ground for the efficiency

of financial management lies in the expertise of a managing board [Van Horne and Wachowicz 2008]. This expertise is manifested in two ways. Firstly, financial manager defines a range of investment opportunities which can potentially generate maximum cash flow for investors at a specified cost of available capital. Secondly, a manager selects an optimal combination of opportunities and fits available sources of financing within a specific financial strategy. Such an approach justifies an increased attention to research in behavioral finance and managerial attitudes as an attempt to explain diversified financial management strategies and efficiency of companies running business in similar conditions and having equal market opportunities [Jacoby and Weston 1952]. Advanced studies of practice of financial management and attitudes of CEO's and CFO's to some issues of corporate finance were conducted in companies of the USA [Graham and Harvey 2001], Western Europe [Brounen et al. 2004] and Poland [Chojnacka 2010, Zabolotnyy 2012]. These studies were based on surveys addressed to financial managers and concentrated on practical problems of corporate finance with a focus on issues of capital budgeting, cost of capital, capital structure and working capital management. The importance of a problem of "unique" financial strategies and human factor in financial management is becoming ever greater in agricultural sector which requires adjusting traditional financial decisions according to such specific risk factors as operational cycle length or seasonality [Wawrzynowicz, Wajszczyk and Baum 2012].

GOAL AND METHODOLOGY

The goal of the research is to study current practices of financial management in Ukrainian companies from agribusiness sector. The research was conducted in the form of a survey including questions on corporate goals, hierarchy of stakeholders, importance of particular areas of financial management, capital budgeting techniques and capital structure decisions. Surveys were addressed to chief executive officers (CEO's) and chief financial officers (CFO's) of Ukrainian companies from agribusiness sector. Finally, the research embraced 13 agricultural firms. The study was conducted in 2016. Received empirical material helped to confront business practice of Ukrainian managers with theoretical concepts aiming to understand motives of financial decisions and their conformity to existing academic views. The results of a research were also compared to earlier studies of other authors conducted for the companies in the USA, Western Europe and Poland.



RESULTS

The analyzed sample of companies was characterized by a considerable diversification in terms of market history, size and employment (Figures 1–3)¹. The majority of companies was operating on the market more than 10 years (53.8%), while only one of them had a market history of less than a year. All other companies have been running business from 4 to 10 years (38.5%). Approximately forty percent of companies employed less than 50 employees (38.5%) and almost one-fourth of the group had more than 500 workers (23.1%). Companies employing 51–250 people presented 30.8% of all entities and one of them had 251–500 workers. The revenue of almost a half of companies was less than 50 mln UAH (46.2%), another 30.8% had revenue of 100–499 mln UAH and remaining firms generated annual revenue of more than 5,000 UAH.

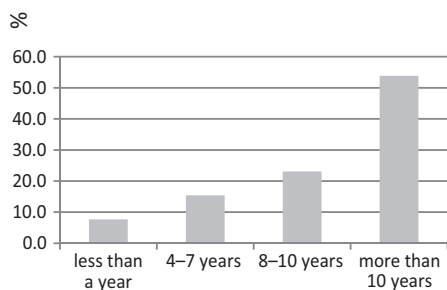


FIGURE 1. How long does the company operate in a market?

Source: Own research.

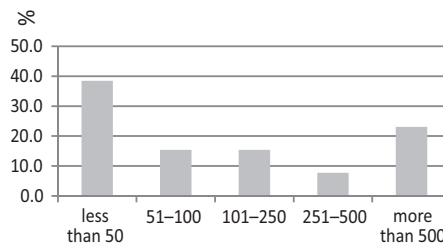


FIGURE 2. What was the average employment during last 3 years?

Source: Own research.

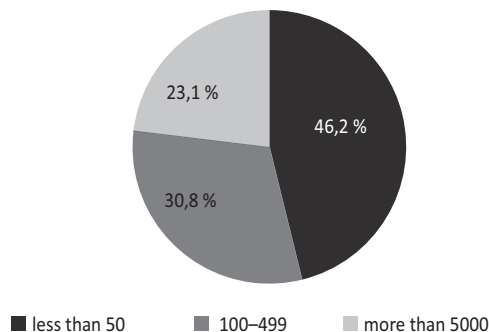


FIGURE 3. What was the average sales revenue during last 3 years (mln UAH)?

Source: Own research.

¹ Figures present only choices selected by respondents.

More than a half of companies (61.5%) was characterized by a slow rate of sales growth of 1–5% during last three years (Figure 4). Only 15% of entities demonstrated a rapid increase of sales (21–30%), equal to a number of firms with a moderate growth (6–20%). It should be mentioned that one company had no sales revenue growth during last 3 years (7.7%).

One-fourth of companies had a loss during last three years while almost a half of them demonstrated an average rate of return on assets of 2–10% (Figure 5). There was a group of companies (30.8%) achieving a high efficiency of their assets (11–30%). A similar discrepancy of capital investments rate was noticed in the sample (Figure 6). The majority of analyzed companies (66.3%) presented a relatively low share of capital investment in sales revenue (0–10%), including almost one-fourth of firms with no capital investments during last 3 years. More than thirty percent of entities had 21–30% or more of capital investments share in sales revenue. Such a dispersion gave an evidence of a high polarization of Ukrainian agribusiness companies in terms of growth and development. This was consistent with results of earlier studies of agrarian entities in Ukraine based on larger samples [Prokopa, Berkuta and Betliy 2010].

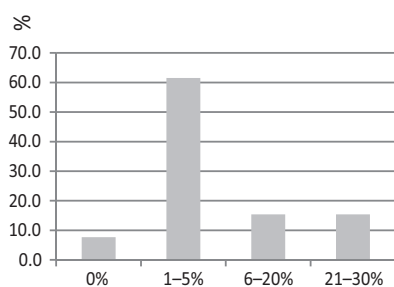


FIGURE 4. What was the average sales revenue growth during last 3 years

Source: Own research.

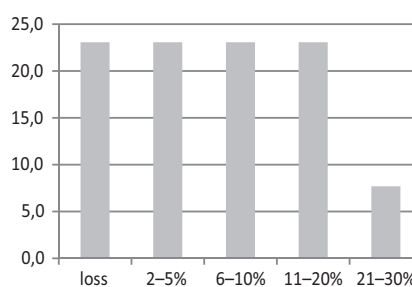


FIGURE 5. What was the average return on assets during last 3 years?

(0–2% did not occur)

Source: Own research.

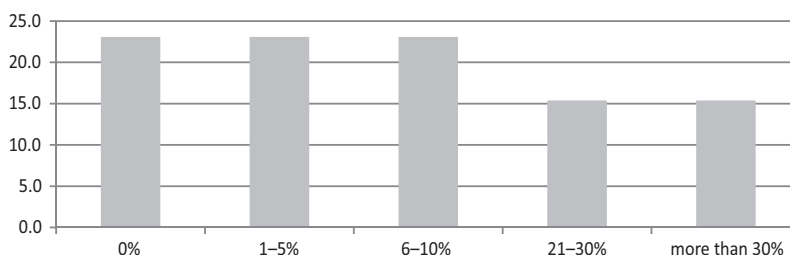


FIGURE 6. What was the average capital investment share in sales revenue during last 3 years?

Source: Own research.

Expertise of chief executive officers can highly influence the quality of financial management process. Figures 7–10 present summary information on top managers of Ukrainian agribusiness companies.

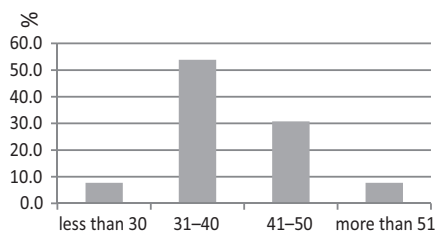


FIGURE 7. CEO Age

Source: Own research.

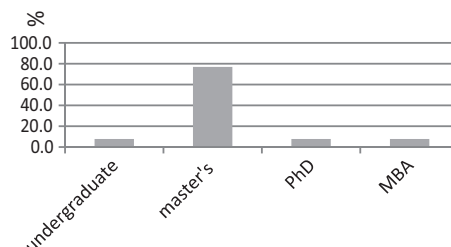


FIGURE 8. CEO Education

Source: Own research.

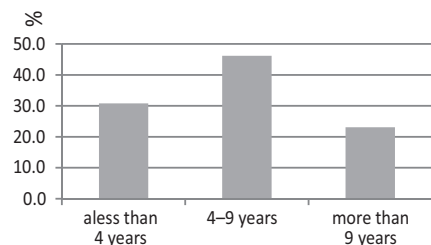


FIGURE 9. CEO Tenure

Source: Own research.

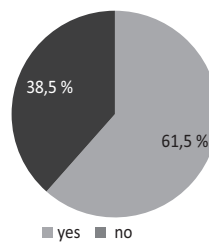


FIGURE 10. Equity in managers ownership

Source: Own research.

The majority of chief executive managers (53.8%) was between 31 and 40 years, while only one-third was between 41–50 years. Almost all CEO's had master's degrees (76.9%) and nearly half of them worked between 4 and 9 years in the company. Only more than 15% acquired PhD and MBA diplomas and one-fourth had more than 9 years tenure in the company. A large number of CEO's had their share in companies' ownership (61.5%) that could be viewed as an additional motivation factor for managers and a signal of better performance of a company [Fauzi and Locke 2012].

Understanding goals of a company helps to evaluate an overall financial management process (Figure 11). Respondents were offered to score an importance of particular goals on a scale from 0 (not important) to 4 (very important)².

² The same scale is used for further questions.

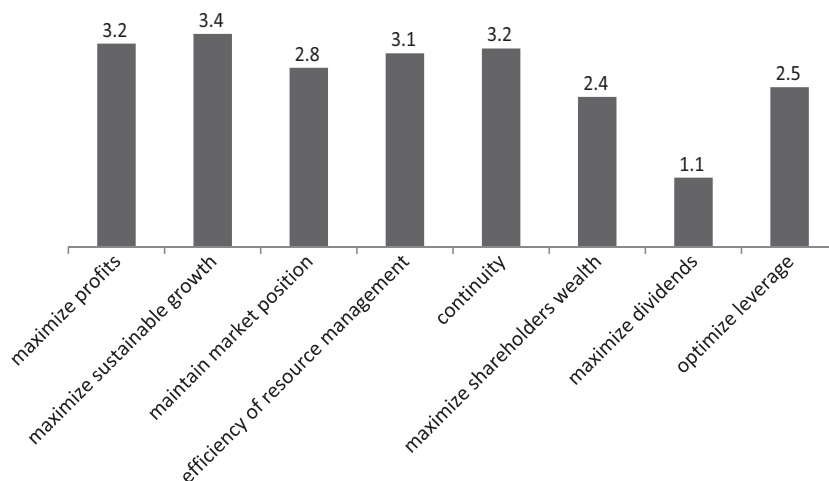


FIGURE 11. Goals of financial management of Ukrainian agribusiness companies
Source: Own research.

Chief executive officers of Ukrainian companies tried to apply a multidimensional approach in their corporate policy that is consistent with stakeholder theory of financial management. This approach implies an attempt to find a compromise between interests of different groups of stakeholders within an overall business strategy of a company [Fassin 2007]. Among the most important goals of companies were sustainable growth maximization (3.4), continuity of business (3.2) and maximizing profits (3.2). At the same time the principle of shareholders' wealth maximization was less popular (2.4) as well as maximization of dividends (1.1). A high priority for the efficiency of resource management (3.1) signaled the need for use of advanced managerial tools and methods in business. Low score for the goal of optimizing leverage (2.5) demonstrated less importance of capital structure policy in comparison to market and efficiency orientation. Responses of Ukrainian CEO's were consistent with results from earlier research conducted among managers of some European countries [Brounen et al. 2004] and Polish managers from agribusiness sector [Zabolotnyy 2012].

Ukrainian CEO's differently evaluated the importance of particular groups of stakeholders within multidimensional strategies of their companies (Figure 12).

On the one hand customers were the most important group of stakeholders for Ukrainian CEO's (3.6). This gave an evidence of a strong market orientation of the analyzed entities. On the other hand value-oriented approach was proved by a relatively high importance of board (3.1) and shareholders (3.2). A low rates for employees (2.2) demonstrated a dominant position of employers in Ukrainian labor market, while moderate grade for suppliers of goods and services (2.8)

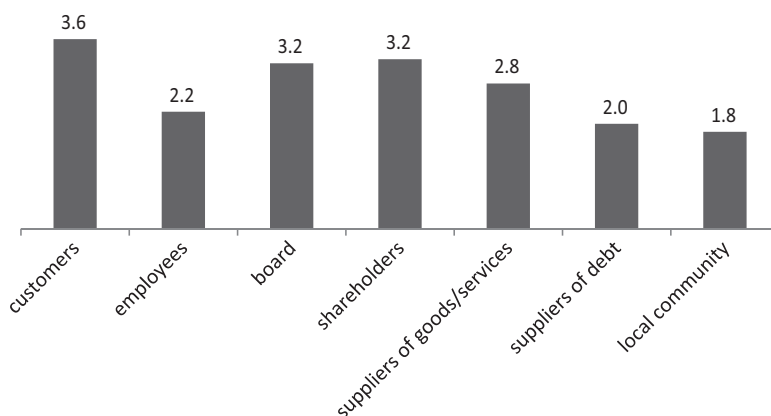


FIGURE 12. Importance of stakeholders for Ukrainian agribusiness companies

Source: Own research.

showed the dependence of this group on their buyers. Low scores for suppliers of debt (2.0) showed little significance of debt financing in analyzed companies. Local community was not also very important (1.8) that showed the limited popularity of social responsibility concept among Ukrainian CEO's. Generally, the responses of Ukrainian managers were consistent with results of a survey in Polish companies. Nevertheless, in Poland CEO's paid higher scores for employees, suppliers of goods and debt and local community that could appear from a comparatively greater maturity of Polish corporate culture [Zabolotnyy 2012]. Remarkably in many Western European companies employees were more important than board and shareholders and the popularity of local community was equal to suppliers of debt [Brounen et al. 2004].

Ukrainian managers saw different priorities of financial management in their companies (Figure 13). The most important area was control, analysis and reporting (3.1). This probably derived both from a necessity of a broad information for the board and shareholders as well as from requirement for detailed financial statements for Ukrainian tax authorities and other governmental bodies. Importance of working capital management (2.9) was connected to a great volatility of Ukrainian economic conditions influenced by high rate of inflation, scarcity of financial resources and decrease of demand for goods and services. This required carefully planning of cash flows, volume and structure of current assets and liabilities. Relatively less popularity of capital budgeting (2.4) and capital structure policy (2.4) could appear from low growth rates of capital investments and limited financing in the majority of analyzed companies.

A low importance of risk management (2.0) in Ukrainian agricultural companies was embarrassing. For example Polish CEO's paid much more attention to this area [Zabolotnyy 2012]. The only reason for this situation could be con-



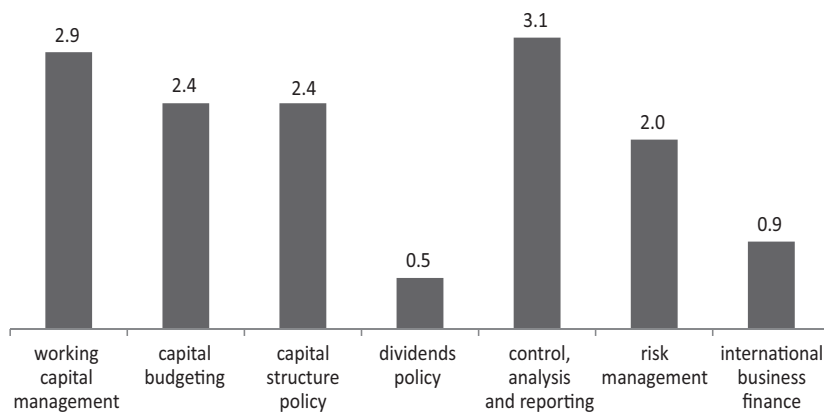


FIGURE 13. Priority areas of financial management in Ukrainian agribusiness companies
Source: Own research.

sidering risk factors and risk management processes as integral components of other areas, such as working capital management or capital budgeting. An insignificance of dividend policy (0.5) in CEO's opinions signaled the lack of dividend payments in Ukrainian agribusiness companies. International business finance was not important (0.9) because of limited exposure of studied companies on global financial markets.

Capital budgeting decisions often depend on methods used for evaluation of particular investment projects. Ukrainian managers chose various techniques of capital budgeting (Figure 14).

Profitability index (2.9) was selected as the most popular method of investments evaluation. In spite of great attention to profitability of investment projects it was difficult to assess whether the calculation of this metric by CEO's was consistent with financial textbooks. Other popular capital budgeting techniques included net present value (1.8), internal rate of return (1.6), payback period (1.6) and discounted payback period (1.7). Such techniques as hurdle rate (1.4), accounting rate of return (1.4), sensitivity analysis (1.2) and adjusted present value (1.1) were less frequently-used. Earnings multiply approach (0.9), value at risk (0.9) and real options concept (0.7) were the least popular. The results of the survey were different from studies of the USA companies where the most important techniques were net present value and internal rate of return, while profitability index was among minor methods [Graham and Harvey 2001]. The same divergence in CEO's views was notices in case of Western European companies [Brounen et al. 2004].

Different risk factors were considered by Ukrainian CEO's in evaluation of investment projects (Figure 15).



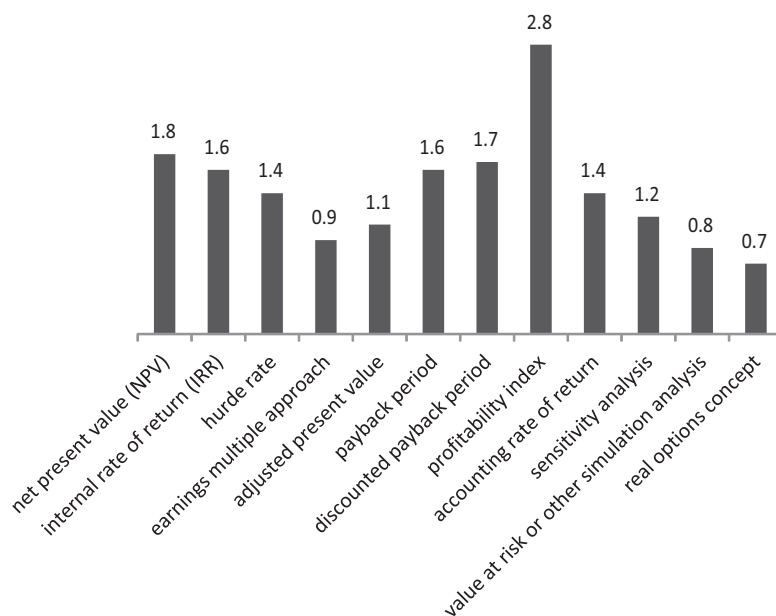


FIGURE 14. Capital budgeting techniques used in Ukrainian agribusiness companies
Source: Own research.

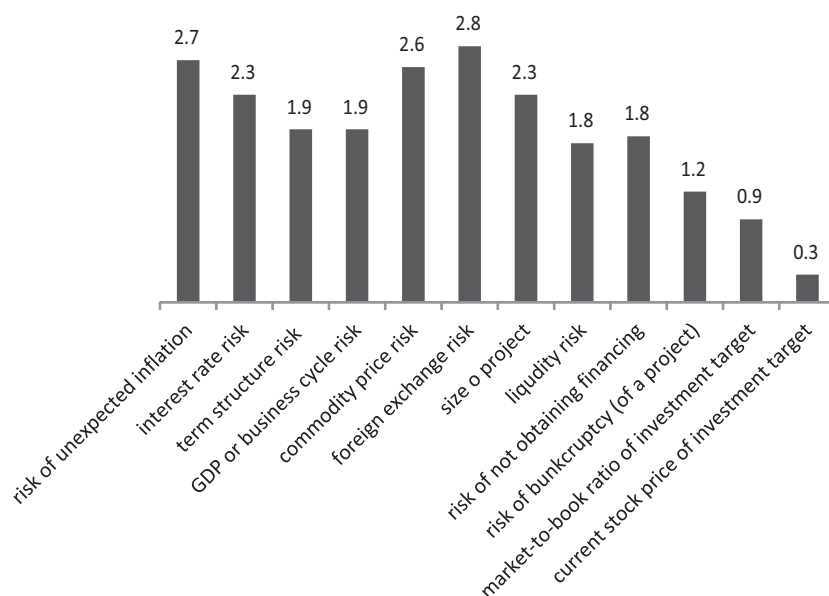


FIGURE 15. Risk factors influencing investment decisions of Ukrainian CEO's
Source: Own research.



The most important risk factors were associated with highly changeable economic conditions including foreign exchange risk (2.8), risk of unexpected inflation (2.7), commodity price risk (2.6). This could be explained by an overall depression of Ukrainian economy caused by political crisis. Interest rate risk (2.3) and size of project (2.3) were also taken into account in capital budgeting process. Term structure risk (1.9), risk of liquidity (1.7) and risk of not obtaining financing (1.8) were less important. It could be explained by the short-term nature of these risk factors whereas investment decisions consider a longer time horizon. Factors connected with a market price of a company were irrelevant because analyzed firms didn't issue stock. Such responses of Ukrainian CEO's were in line with the results received in studies based on the companies from USA [Graham and Harvey 2001] and Western Europe [Brounen et al. 2004].

Less importance of interest rate and credit risk factors could be explained by a high preference to own sources of financing of investment projects (Figure 16).

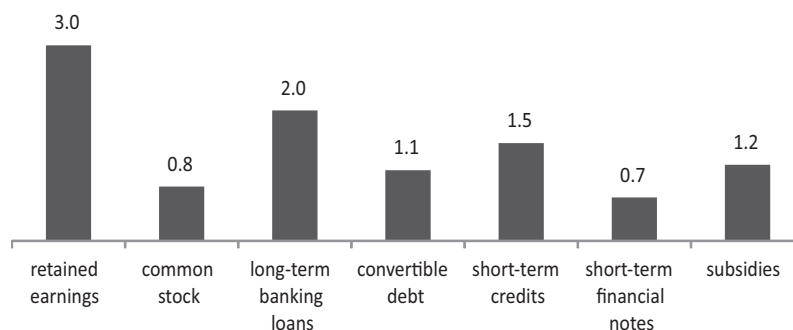


FIGURE 16. Sources of financing of new investment projects in Ukrainian agribusiness companies

Source: Own research.

Generally the results of a survey gave an evidence of a pecking-order theory of financing. According to this theory companies use external financing only when internal funds do not cover their capital needs [Kuryłek 2014]. When using external sources firms prefer debt, convertible securities and equity. In Ukrainian companies new investment projects were financed first of all from retained earnings (3.0) and long-term banking loans (2.0). The popularity of external sources of financing was as follows: short-term credits (1.5), subsidies (1.2), convertible debt (1.1), common stock (0.8) and short-term financial notes (0.7). The responses of Ukrainian CEO's were consistent with the findings of Graham and Harvey [2001] and Brounen et al. [2004]. It should be mentioned that Polish managers of agribusiness companies also applied the similar approach to capital structure policy [Zabolotnyy 2012].

SUMMARY

In the paper the practice of financial management of Ukrainian companies from agribusiness sector was studied. According to the results of a research the following conclusions were formulated:

1. Ukrainian agribusiness companies were highly polarized in terms of market potential, profitability of assets and volume of capital investments. This could greatly affect managerial attitude to corporate finance and methods used in financial management.
2. A multidimensional approach oriented on such goals as sustainable growth, continuity and maximizing profits was applied in Ukrainian agribusiness companies. This gave an evidence of a stakeholder theory as a compromise between goals of different groups of actors in the company. Furthermore, pursuing different goals in the process of financial management signaled a search for a balance in a risk-return relation.
3. Ukrainian managers tried to concentrate on different groups of stakeholders with a particular focus on customers, board and shareholders. The reason for client orientation could be a highly competitive business environment and aspiration for market share maximization. A high priority for investors and board was dictated by a necessity of their wealth maximization that was consistent with a shareholder theory.
4. A great importance of control, analysis and reporting in financial management derived from a need for detailed financial information for board and shareholders as well as for Ukrainian tax authorities and other governmental bodies. Efficient working capital management was a necessary condition for continuity of operations in highly volatile Ukrainian market. Managers of developing companies also paid much attention to capital budgeting, capital structure and risk management.
5. The most preferable capital budgeting technique was profitability index, while net present value and internal rate of return were less popular. This proved managers' adherence to profitability criterion in investment project evaluation and signaled a shareholder approach. In evaluation of investment opportunities managers generally considered macroeconomic factors such as foreign exchange risk, risk of unexpected inflation and commodity price risk. This was strongly related to economic and political instability in Ukraine.
6. Ukrainian managers were strongly supporting the pecking-order theory of capital structure. Firstly, new investment were financed by internal source of financing such as retained earnings and secondly by external funds including long-term banking loans, short-term credits, subsidies, convertible debt and common stock.



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ZASADY ZARZĄDZANIA FINANSAMI W PRZEDSIĘBIORSTWACH Z SEKTORA AGROBIZNESU NA UKRAINIE

Abstrakt. Celem artykułu jest rozpoznanie praktyk zarządzania finansami w ukraińskich przedsiębiorstwach z sektora agrobiznesu. Ukraińscy menedżerowie stosowali wielofunkcyjne podejście w zarządzaniu finansami, zorientowane na takie cele jak zrównoważony rozwój, zapewnienie ciągłości funkcjonowania



oraz maksymalizacja zysków. Duże znaczenie kontroli, analizy i raportowania w zarządzaniu finansami wynikało z zapotrzebowania na szczegółową informację finansową, zgłaszanego przez zarząd i właścicieli oraz ukraińskie urzędy skarbowe i inne organy państwowe. Efektywne zarządzanie kapitałem obrotowym było niezbędnym warunkiem zapewnienia ciągłości działalności w warunkach dużej niestabilności rynkowej na Ukrainie. Najpowszechniejszą techniką stosowaną w budżetowaniu kapitałowym był wskaźnik zyskowności inwestycji, natomiast wartość bieżąca netto i wewnętrzna stopa zwrotu cieszyły się mniejszą popularnością. Ukraińscy menedżerowie wykazały się dużym poparciem dla teorii hierarchii źródeł finansowania w strukturze kapitałowej.

Słowa kluczowe: zarządzanie finansami, budżetowanie kapitałowe, struktura kapitałowa, agrobiznes

