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Financial Appraisal as the Basis for Development of the Efficient Corporate Financial Strategy in the Context of Economic Instability

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Abstract:

Economic entities are faced today with the challenge of ensuring a timely flexible response to rapidly changing environmental conditions, which is connected with the development of an efficient financial development strategy. There is the growing awareness in the business community that despite the difficulties of functioning of the economy's real sector much depends on the companies and their decisions in the field of strategic financial management. As a result, an increasingly important role is attributed to the development of methodological tools to financially appraise the performance of a company operating in an environment of economic instability, which can be applied to improve business resilience to internal and external shocks.

The fundamental concepts and scientific hypotheses presented in the papers of the economic science classics, contemporary foreign and Russian scholars and specialists in the field of organizations' strategic financial management served as theoretical and methodological basis for the study.

The research methodology is based primarily on the systemic, structural, abstract and logical methods of economic analysis. General scientific methods of cognition (logical, comparative) and traditional methods of research (computational, practical, statistical, retrospective, tabular, graphic) were also used in the work.

During the study, an approach to the establishment of a composite indicator has been developed and implemented, which allows to objectively appraise the financial condition of the object under study along with the methods of diagnostics that exist in the theory and practice of financial management. The authors presented an algorithm used to appraise the financial condition of an enterprise operating in the unstable environmental conditions. The applied novelty of the obtained results consists in the development of major provisions of the financial resources management strategy for a commercial enterprise operating in the conditions of uncertainty in the external and internal environment.

Keywords: financial management; financial appraisal; financial indicators; financial strategy; management strategy; company; economic instability.

JEL Classification: D04; M21; L19; G17; D81; G32.

Introduction

Financial management is the key to the efficient performance of the business entity. Success of the commercial work depends on rational distribution of resources, their competent use, strategic planning of the revenue and expenditure budgets. At the same time, the economic essence of any enterprise is always associated with uncertainty of achieving final results and hence with the risk of losses. Shock processes that occurred in the global economy in 2008 – 2009 significantly adjusted the process of enterprises conducting business activities. Practice of the global economic crisis demonstrates that a thorough financial analysis of economic entities' activities is required.

To date, a significant number of indicators and models have been developed to assess the corporate financial condition. However, in the context of changing external environment, each company should be able to develop its own criteria for performance appraisal, depending on the conditions of its operation, industry and size in order to timely diagnose the occurrence of a crisis situation. As a result, the most important factors of the economic entity's efficient operation on the market, its expertise expansion and profit earning include intensifying efforts of the company's financial department towards systematic monitoring of changes in financial results and timely identifying the signs of a crisis situation in the company.

Relevant problems of strategic management at enterprises were covered in the works of Mintzberg (1994), Grant (1999), Ansoff (1993), Hussey (1998), Gradov. (1996, 2003), Gryaznova (2012), Sheremet (2013), Utkin (1998), Bouhali (2015). Issues of analyzing the corporate financial condition are constantly at the center of attention of scholars and practicing economists. The methodology for conducting financial analysis is considered in the works of such well-known scholars as Abdukarimov (2013), Sheremet (2013), Endovitskaya. (2012), Grechenyuk (2015), Jiřina Bokšová (2015), Santis (2016), Ponomareva (2016), Bircea (2012), Santis (2016). Theoretical and methodological approaches to establishment of financial strategy are covered in the works of Ansoff (1993), Analoui (2012), Lukasevich (2013), Böhm (2017), Brigham, Houston (2014), Brealey (2008), Gentry (1988), Teirlinck (2017), Savina, Kuzmina-Merlino (2015), Soboleva, and Parshutina (2016), Soboleva, Golaydo, and Lygina (2015), Pavlíček (2009), and others.

Scientific achievements served as a basis for studying the issue of the efficient strategic management of the organization's finances in unstable conditions. However, the methods of appraisal and forecasting of corporate financial condition in the context of instability that exist in the theory and practice of strategic financial management are often not adapted to operating conditions of a specific industry or country. Existing methods cannot be called universal. A flexible approach to their application should be ensured in practice. A range of views on the procedure for conducting diagnostics of corporate financial condition and its constituting appraisal indicators as a fundamental stage that ensures the development of the efficient financial management strategy remains very wide. Insufficient elaboration of the procedure for the establishment and implementation of the organization's financial management strategy in the context of economic instability determined the relevance of this research and the range of issues that require study.

1. Method

1.1. Strategic Financial Management as a Process

Strategic management at the enterprise is a way to achieve its goals. It is a set of actions and decisions under the guidance of managers that ensure the development of functional strategies for achieving the core corporate goals. This process is designed to ensure a proper managerial decision. Its task is reduced to ensuring innovations and changes at the enterprise in the required volume and during the required period of time.

The goal of the strategic management is to define the most promising areas of the enterprise's activity that ensure its growth and prosperity. Initially, this concept was introduced in order to distinguish this set of actions from the process of the long-term planning and from the current, operational planning. As is known, the goal of operation of the commercial organization is to extract profit on an ongoing basis. A competitive advantage over competitors must be sustainable in order to ensure that the return on investment is higher than theirs. This is possible only if the quality of goods and services offered to consumers is higher than that of competitors. Achieving stable profit requires investment in the development of production opportunities that ensure the preservation of competitive advantage for the future. As a result, it can be argued that the strategy depends on specification of the desired competitive advantage, availability of resources or opportunities that can ensure a stable advantage of the enterprise in the changing market conditions.

Major components of strategic management are the following:

(1) Definition of the company's mission – defining the company's purpose of existence, its aim, role and place in business;

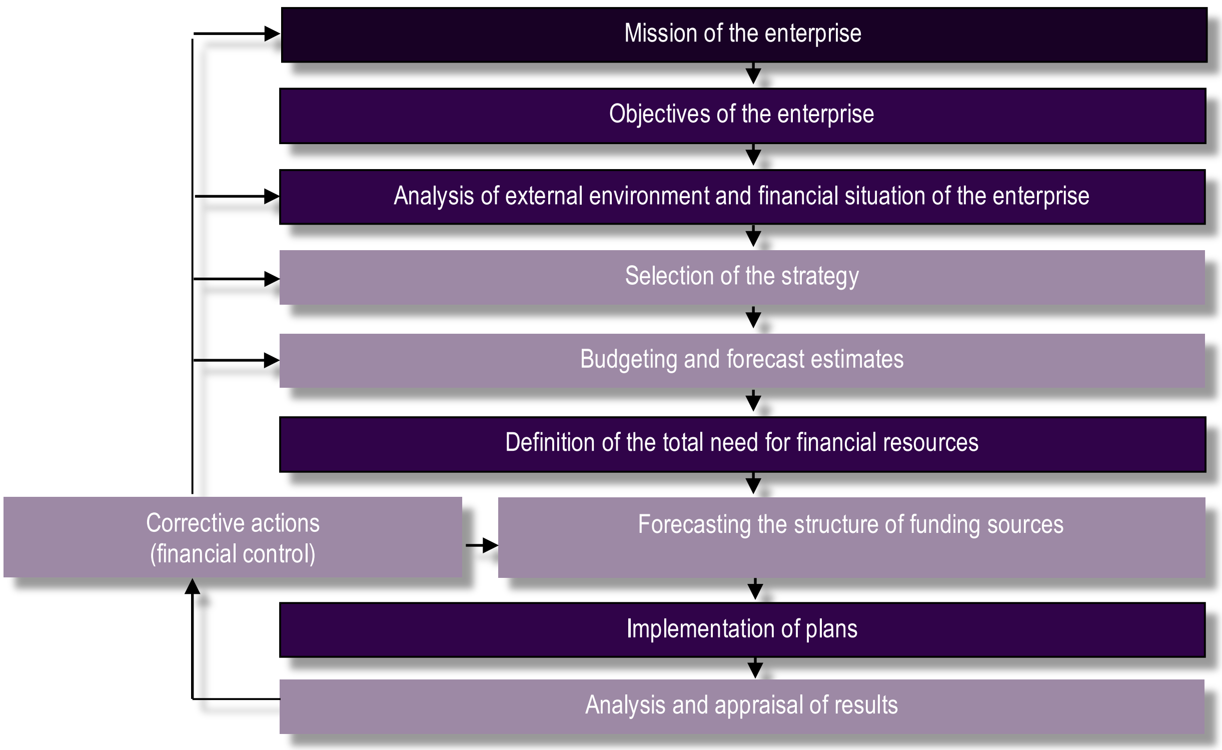
(2) Formulation of goals and objectives: they should provide motivation for the employees of the enterprise. The goals should be quantitatively measurable, in the first place;

(3) Analysis and appraisal of the external environment provide a basis for the development of the corporate strategy;

(4) Analysis and appraisal of the internal environment is aimed at definition of the internal capabilities and the potential that an enterprise can use in competition to achieve its goals;

(5) Development and analysis of strategic alternatives, selection of strategy. It is customary to distinguish the following at the stage of the strategy selection: (a) development of the basic strategy of the company development; (b) development of its functional strategies that support and implement the basic strategy.

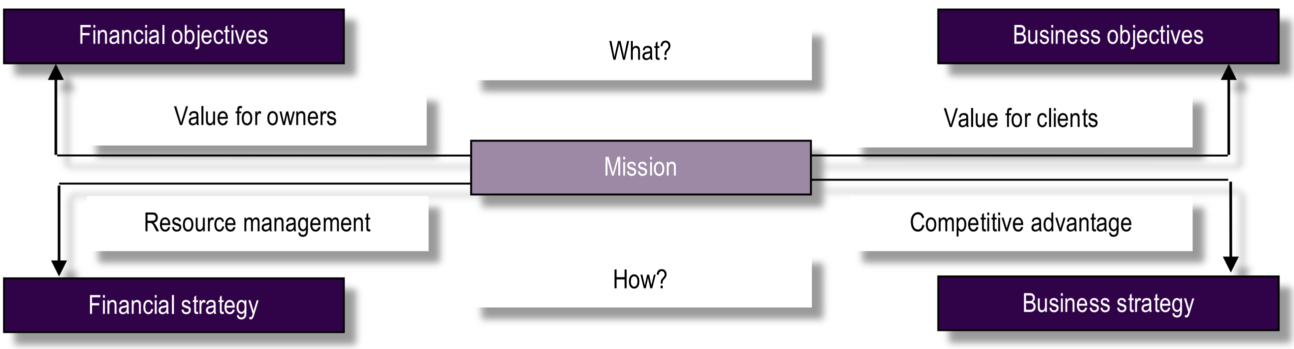
Strategic management of the company has been and remains a very relevant topic. The financial strategy is the central part of the general, unified corporate strategy. Each enterprise should have a strategy for achieving sustainability and competitiveness (it is the foundation of the financial strategy). Crisis management comes to the fore at this stage of the Russian economy development and in the context of the economic crisis. It is important to realize the place and time of conducting crisis management in the general strategy of the company management and development, since the development of all companies is uneven and crises (both external and internal) are customary. The key stages of the strategic financial planning process at the enterprise are shown in Figure 1.



Source: Compiled by the authors.

Figure 1. Stages of the strategic financial planning process at the enterprise

Figure 2 illustrates the parameters of the firm's development towards its mission and objectives.



Source: Compiled by the authors.

Figure 2. Relationship between the corporate mission and strategic objectives in the field of financial management

Financial strategy involves creating and using financial resources to implement the basic strategy of the organization and develop appropriate plans of action. It allows to form and optimize financial resources, and to define the structure and area of their efficient use in order to achieve the objectives of the enterprise operation. The financial strategy is important because the financial resources reflect the results of the company's operating, investment and financial activities and balance the targets aimed at achieving the objectives of the company's operation. On the other hand, finance is the source, starting point for the development of other functional strategies, since financial resources often act as one of the most important restrictions on the scope and field of the enterprise operation. It follows from the above that the financial strategy is part of strategic planning and management, on the one hand, and acts as an element of financial management, on the other hand.

Actions of the company's executives aimed at ensuring the achievement of the objectives are coordinated on the basis of developing a certain financial management system. The interrelation and interaction of management functions at the company are presented in Figure 3.

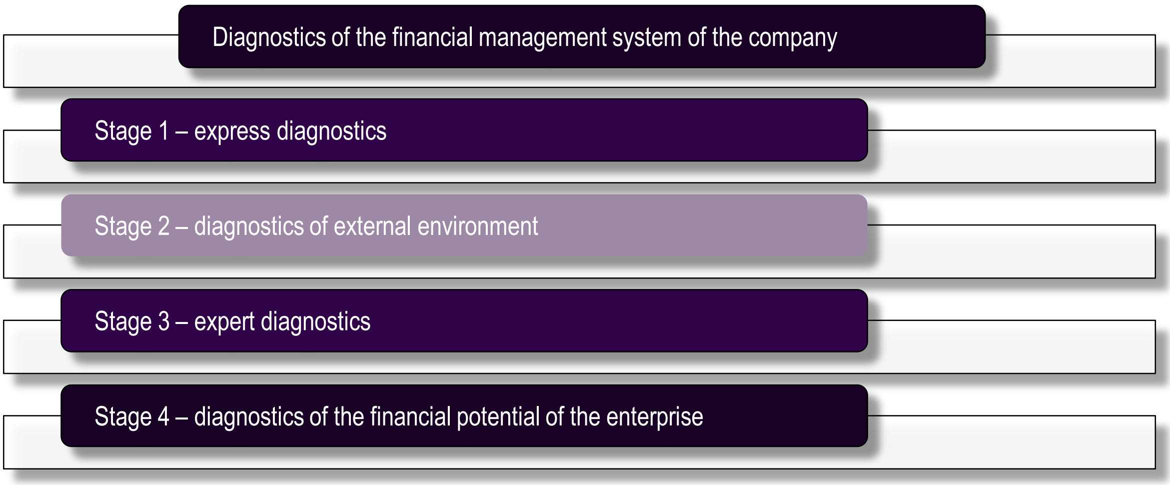
Figure 3. Interrelation of general management functions

Financial analysis is a starting point of financial planning, on the one hand, and its final stage, on the other hand, as it executes a financial control function of the implementing the developed strategic plan. Analysis of the financial and economic condition of the enterprise is the foundation that underlies the development of the corporate financial policy. The quality degree of such an analysis affects the efficiency of managerial decisions. The stable position of a commercial organization is based on financial stability. The higher the stability of the enterprise, the more it is independent of the unexpected change in market conditions and, as a result, the lower the risk of finding itself on the verge of bankruptcy. Appraisal of financial stability in the short term interacts with the liquidity of the balance sheet and the organization's solvency.

The emphasis in strategic financial management in the context of economic instability should be made on the timely diagnosis of the financial condition. As a result, it is considered necessary to improve the existing approach to the procedure of developing and implementing a financial strategy based on financial analysis in order to optimize the strategic financial management system of the modern commercial enterprises.

1.2. Diagnostics of the Financial Condition of the Company in the Strategic Financial Management System

Theoretical study of domestic and foreign scholars in the field of financial management and diagnostics of the companies' financial condition allowed to make the following conclusion. Diagnostics in the field of financial management of a commercial enterprise is a certain set of ways and methods to examine the company's internal and external environment in order to identify ways of improvement or reasons for its financial deterioration. At the heart of diagnostics of the company's financial management system there is a process of researching the factors of the internal and external environment, appraisal of the company's financial condition in order to identify the presence and define the depth of the financial crisis and further develop an appropriate financial strategy (Figure 4).



Source: Compiled by the authors.

Figure 4. Procedure for diagnosing a financial management system of the company

Implementation of the proposed mechanism for diagnosing the strategic financial management of the enterprise will allow to timely identify the real and potential problems, to assess strengths and weaknesses, opportunities and threats to the company's activities, and to describe the financial potential of the object under study. Ultimately, the practical implementation of the above procedures will allow to develop an efficient financial strategy for the company operating in the context of instability.

In the context of rapid changes in the external environment, it is advisable to use the opportunities and advantages of monitoring the indicators of the company's financial and economic performance. Monitoring should lie in the basis of developing the company's strategic financial activities.

During the implementation of the study's theoretical part and analysis of the financial and economic activities of the production company, it was found that timely diagnostics of the first symptoms of the company's unfavorable state plays an important role in the process of strategic financial management. However, in order to conduct comprehensive appraisal of the financial situation of the object under study, it is considered expedient to use the so-called composite indicator. Its formation requires to establish the relationship between the composite ratio of financial condition and the financial indicators that affect it. The composite indicator is necessary to obtain an overall picture of the financial condition of a commercial enterprise. It is considered necessary to lay the basic ratios reflecting the financial condition of commercial enterprises at the basis of the equation proposed to calculate the composite indicator.

Upon the study of the relative ratios of appraising the companies' financial condition in the scientific publications, a conclusion was made that it is expedient to limit the set of indicators to certain requirements for their use in the process of diagnostics. The selected financial indicators should be as much informative as possible. They should be calculated on the basis of data from the financial statements and have the same direction. The number of selected indicators should be reduced to a minimum. Such indicators should allow to carry out rating appraisal of the financial condition of the object under study, in case of necessity.

2. Results of the Study

2.1. Consolidated Indicator of the Company's Financial Condition in the Context of Economic Instability

In the context of the unstable economy, high inflation and imperfection of the tax system, a large number of domestic economic agents become insolvent. Their withdrawal from a crisis situation requires mastering the special methods of financial management. The theory and practice of financial management have developed a broad system of methods aimed at diagnostics of insolvency and development of efficient methods to make managerial decisions in the context of instability. An important peculiarity of such methods is possibility and necessity of their application both for companies for which the crisis is obvious and requires urgent stabilization measures and for well-situated companies in order to early recognize the first symptoms of the crisis. It was suggested to use the so-called consolidated indicator of appraising the company's financial condition in order to achieve the greatest positive effect in the development and implementation of the financial management strategy.

It is proposed to apply the instant, absolute and current liquidity ratios, as well as the equity-assets ratio and financial stability ratio in the calculation of the composite indicator. Using the values of the above ratios, the composite indicator will reflect the financial condition of the company from the standpoint of its solvency and financial stability. The formula developed by the authors to calculate the composite indicator of appraising the company's financial condition is as follows (Formula 1):

$$\mathrm{R_{COMP}} = \mathrm{W_{AL}} \times \mathrm{R_{AL}} + \mathrm{W_{IL}} \times \mathrm{R_{IL}} + \mathrm{W_{CL}} \times \mathrm{R_{CL}} + \mathrm{W_{FS}} \times \mathrm{R_{FS}} + \mathrm{W_{EA}} \times \mathrm{R_{EA}} \quad (1)$$

where $\mathrm{W_{AL}}, \mathrm{W_{IL}}, \mathrm{W_{CL}}, \mathrm{W_{FS}}, \mathrm{W_{EA}}$ are weighted ratios;
$\mathrm{R_{AL}}, \mathrm{R_{IL}}, \mathrm{R_{CL}}, \mathrm{R_{FS}}, \mathrm{R_{EA}}$ are values of the corresponding ratios.

It is recommended to determine the weight of individual financial ratios in the composite indicator using the expert opinions. The maximum score was defined as ten. After the expert appraisal of the influence degree of the ratios under consideration on the company's financial condition, an important stage is the weighing procedure, i.e. the reduction of the obtained indicators' values to one unit of measurement. It is proposed to calculate the share of each ratio's weight in their total sum using Formula 2.

$$\mathrm{Y}_j^i = \frac{i}{\sum_{j=1}^{n} i} \quad (2)$$

where i is a value of appraising a specific coefficient by an expert j;
n is a number of experts.
The total share of each ratio is calculated using Formula (3):

$$\mathrm{Y_{sum}} = \sum \mathrm{Y}_i \quad (3)$$

The total specific weight of the *i*-th indicator in its total appraisal $\mathrm{Y}_{i\,total}$ is calculated using Formula (4):

$$\mathrm{Y}_{i\,total} = \frac{\mathrm{Y_{sum}}}{\sum \mathrm{Y_{sum}}} \quad (4)$$

The results of calculating the weighted average values of the analyzed indicators are presented in Table 1.

Table 1. Calculating the weighted average values of the analyzed indicators (units)

Indicator	Y	E	F	Sum of indicator weights	Sum of the indicator weights in the summation
Absolute liquidity ratio	0.24	0.21	0.22	0.67	0.22
Instant liquidity ratio	0.22	0.21	0.20	0.62	0.21
Current liquidity ratio	0.17	0.21	0.17	0.55	0.18
Financial stability ratio	0.12	0.17	0.17	0.46	0.15
Equity-assets ratio	0.24	0.21	0.24	0.70	0.23
Total	1	1	1	3	1

Source: Compiled by the authors.

Consistency degree of expert opinions can be described using the concordance ratio *W* (Formula 5).

$$W = \frac{12S}{n^2(m^3 - m)} \quad (5)$$

where S is a sum of squares of deviations from the arithmetic mean of the ratios;
m is a number of appraisal indicators.
The source data for calculating the concordance ratio are presented in Table 2.

Table 2. Source data for calculating the concordance ratio

Indicator	Y	E	F	Sum of indicator weights	Arithmetic mean	Deviation from the arithmetic mean	Deviation square
Absolute liquidity ratio	10	10	9	29	26	3	9
Instant liquidity ratio	9	10	8	27		1	1
Current liquidity ratio	7	10	7	24		-2	4
Working capital financed by equity to total assets ratio	5	8	7	20		-6	36
Equity-assets ratio	10	10	10	30		4	16
Total	41	48	41	130	–	–	66

Source: Compiled by the authors.

$$W = \frac{12*66}{3^2(5^3-5)} = 0{,}73.$$

The consistency degree of expert opinions is considered satisfactory.

The next stage in the development of the composite ratio for appraisal of the financial condition of the enterprise is to determine the values of the weighted ratios. To do this, the calculated values of the total specific weights of each indicator should be adjusted in their total appraisal by the normative value of each ratio (Formula 6):

$$W_i = \frac{Y_{i\,total}}{R_{min}} \qquad (6)$$

where W_i is weight ratios of indicators;

R_{min} is the lower limit of the recommended value of the indicator.

The following results were obtained in the process of testing the method:

$$W_{al} = \frac{0.22}{0.2} = 1.1.$$
$$W_{il} = \frac{0.21}{0.8} = 0.26.$$
$$W_{cl} = \frac{0.18}{1} = 0.18.$$
$$W_{fs} = \frac{0.15}{0.1} = 1.5.$$
$$W_{ea} = \frac{0.23}{0.5} = 0.46.$$

The composite indicator of appraising the company's financial condition is presented as Formula 7:

$$R_{COMP} = 1.1{\times}R_{AL} + 0.26{\times}R_{IL} + 0.18{\times}R_{CL} + 1.5{\times}R_{FS} + 0.46{\times}R_{EA} \qquad (7)$$

The values of the ratios are substituted by the recommended minimum values for them in order to calculate the minimum value of the indicator (Formula 8):

$$R_{COMP\ min} = 1.1{\times}0.2 + 0.26{\times}0.8 + 0.18{\times}1 + 1.5{\times}0.8 + 0.46{\times}0.5 = 2.038 \qquad (8)$$

The upper recommended values of the indicators are used to define the maximum value of the composite indicator (Formula 9):

$$R_{COMP\ max} = 1.1{\times}0.4 + 0.26{\times}1 + 0.18{\times}2 + 1.5{\times}0.9 + 0.46{\times}0.7 = 2.732 \qquad (9)$$

Results of calculation of the composite indicator can be interpreted as follows:

If R_{COMP} < 2.038, the company is described as in the state of the crisis;

If 2.038 < R_{COMP} < 2.732, the company is not threatened by an unstable (crisis) state;

If $\mathrm{R_{COMP}}$ > 2.732, the company irrationally uses available resources, which can result in financial loss.

The effect of the developed indicator was tested by the example of Quadra PJSC, one of the largest territorial generating companies in the Central Federal District of the Russian Federation (Table 3):

$$\mathrm{R_{COMP}^{2013}} = 1.1\times0.012 + 0.26\times0.88 + 0.18\times1.049 + 1.5\times0.823 + 0.46\times0.56 = 1.923.$$
$$\mathrm{R_{COMP}^{2014}} = 1.1\times0.048 + 0.26\times0.487 + 0.18\times0.603 + 1.5\times0.783 + 0.46\times0.47 = 1.679.$$
$$\mathrm{R_{COMP}^{2015}} = 1.1\times0.062 + 0.26\times0.377 + 0.18\times0.464 + 1.5\times0.757 + 0.46\times0.41 = 1.574.$$

Table 3. Dynamics of the composite indicator for Quadra PJSC (units)

Period	Value	Lower border	Upper border
2013	1,923		
2014	1,679	2,038	2,732
2015	1,574		

Source: Compiled by the authors.

The value of the composite indicator for the entire analyzed period was below the threshold value. The financial condition of the company can be described as crisis. Quadra PJSC occupies an unstable financial position and lacks liquid assets. Due to the above, it is believed that the use of the developed indicator is accepTable, since the conclusions obtained are consistent with the results of the analytical procedures for appraising the company's financial condition.

2.2. Forecast of the 'Crisis Field' Indicators Based on the Retrospective Financial Analysis Using the Index Method

A well-known scientist in the field of financial management, Blank (2004), determined the object list of the crisis field for domestic enterprises. Taking into consideration the specifics of the current stage of economic development and with regard to the object under study, the indicators that should be analyzed on a systematic basis were selected: value of net assets, company's liquidity, financial dependence, turnover of receivables and payables. Appraisal of the selected objects of the crisis field should be supplemented by a forecast of their changes. A retrospective analysis using the index method is recommended in this regard. The authors proceed from the fact that the forecast should be logically compatible with the retrospective indicators of the company's performance. Appraisals based on forecasts that significantly differ from historical trends cannot and should not be deemed accurate. Retrospective analysis implies obtaining information for the past periods of time in order to assess the dynamics of the object under study. With this background, the scheme of monitoring the financial and economic condition of the enterprise outlined above is supplemented by retrospective analysis. As such, the analysis of the company's external and internal environment, express diagnostics and expert diagnostics is supplemented by retrospective financial analysis (Table 4).

Table 4. Index method at the basis of retrospective financial analysis of the activities of Quadra PJSC

Indicator	Value of indicator, thous. rub.			Index, units		
	2013	2014	2015	2013	2014	2015
Total balance assets	62,831,869	67,292,359	66,201,821	0.000	1.324	1.000
Short-term liabilities	11,113,599	14,597,749	16,092,796	0.000	0.700	1.000
Long-term liabilities	16,257,703	21,177,324	22,995,527	3.706	1.000	0.000
Receivables	9,646,509	6,411,757	5,073,980	-2.418	0.000	1.000
Revenue	41,344,580	41,644,148	42,094,557	0.000	0.399	1.000

Source: Compiled by the authors.

Formula 10 was used to calculate the indices for each of the considered indicators.

$$\mathrm{Index} = \frac{\mathrm{Actual-Minimum}}{\mathrm{Maximum-Minimum}} \quad (10)$$

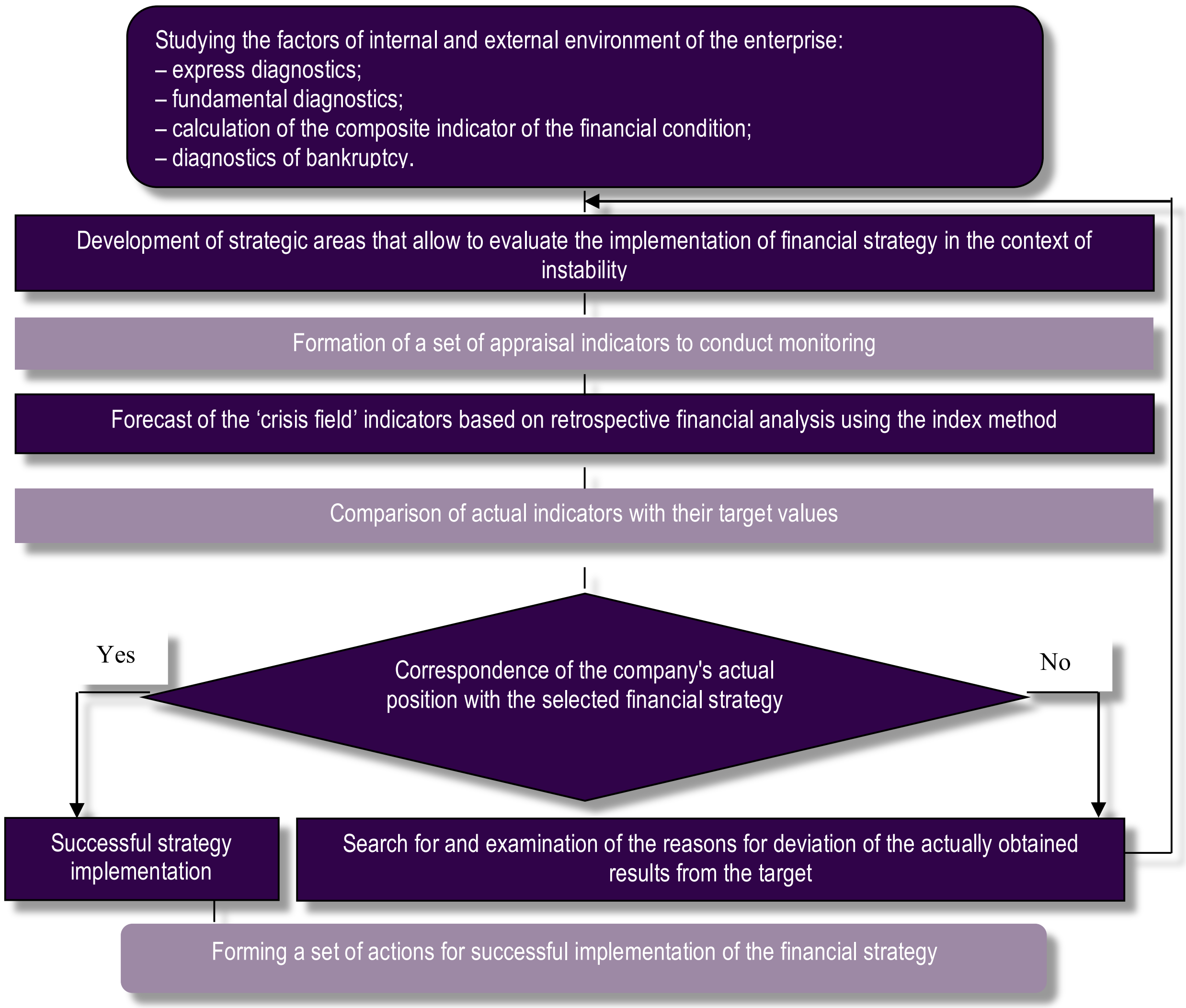
where Actual is an actual value of the indicator;
Minimum is a minimum value of the indicator;
Maximum is a maximum value of the indicator;
Results of the forecast of the indicators under consideration are presented in Table 5.

Table 5. Forecasted indicators on the basis of retrospective financial analysis of Quadra PJSC activities (units)

Indicator	Average index value	Average minimum	Forecast of the index for 2016	Forecast of the indicator for 2016 (thous. rub.)
Total balance assets	0.775	0.500	1.275	67126992.33
Short-term liabilities	0.567	0.350	0.916	15676790
Long-term liabilities	1.569	0.000	1.569	26826564
Receivables	-0.473	-1.209	-1.682	8661458
Sales proceeds	0.466	0.200	0.666	41844212

Source: Compiled by the authors

A mechanism for implementing the proposed approach to financial analysis in the process of implementing the strategic financial management at domestic enterprises is presented in Figure 5.



Source: Compiled by the authors.

Figure 5. Algorithm of developing the efficient corporate financial strategy in the context of economic instability

The proposed algorithm is built on the basis of classical models of strategic financial management. The novelty of the approach lies in applying the financial appraisal of the company's activities at several stages of developing and implementing the company's financial management strategy. It is proposed to use the methodology of financial analysis based on the calculation of the composite indicator at the economic instability appraisal stage, while the mechanism for forecasting the financial condition of the company based on the index method is proposed at the financial strategy implementation stage. Synthesis of the proposed approaches to financial appraisal can be regarded as a powerful tool for increasing the efficiency of the process of developing and implementing the efficient corporate financial strategy in the context of economic instability.

3. Discussion

A method for calculating the composite indicator of the appraisal of the financial condition is not limited to its use in the production of energy resources. The developed methodological recommendations can also be used in other sectors of the economy subject to the restriction that the calculations must include the minimum and maximum values of the ratios recommended for a specific industry and a particular region. Such an approach to the financial appraisal of the company's activities will complement the results of the analysis obtained based on well-known domestic and foreign methods, and the results obtained will serve as a guide for the development of the corporate financial strategy in the context of instability. An important peculiarity of the developed provisions is optimizing the algorithm for company's financial analysis in the context of uncertainty.

Conclusion

The performed study allowed to draw conclusions that the emphasis in strategic financial management in the context of uncertainty described by economic instability should be made on the large-scale use of financial appraisal methods both at the stage of diagnosing the external and internal environment of the company and at the stage of forecasting 'crisis field' indicators in the financial strategy implementation process. In the former case, it is advisable to calculate the so-called composite indicator of financial appraisal, which takes into consideration the most significant financial indicators for the company. In the latter case, it is recommended to give a forecast estimate of financial indicators based on retrospective analysis, the dynamics of which largely depends on the instability of the company's external and internal environment and influences the efficiency of the financial strategy implementation. Due to this, the article presents an algorithm for assessing the financial condition of an enterprise operating in the context of unstable external environment in order to optimize the system of strategic financial management. The authors also proposed an approach to the formation of a composite indicator, which allows to provide an objective appraisal of the financial condition of the object under study and complements the methods to diagnose the financial and economic activities of an enterprise existing in the theory and practice of financial management.

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