Some Aspects of the Formation a Financial Strategy in Emerging Markets

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Abstract

The article describes the main problems of formation and implementation of financial strategies of companies in emerging capital markets. The authors propose a methodological basis to resolve the identified problems - the use of both classical matrix of financial strategies, and developed and tested on the Russian market of the matrix of optimal capital structure. In today's globalized markets, the presence of a financial strategy is a prerequisite not only to maximize the company's market value, but also to improve its competitiveness and sustainability.

Keywords: *emerging markets, financial strategy, classical model of financial strategies, matrix of optimal capital structure, cost indicators*

1. Introduction

The growth of economic practice and financial system is characterized by the increasing role of strategic management in the area of finance that is determined by such trends as globalization, an increase in the amplitude of the fluctuations in the world financial market, an increase in energy prices, growth of the share of innovation in sectors of the economy, inefficient management practices in the current activity.

In such circumstances, it is of special importance to develop a realistic financial strategy which should effectively integrate into the overall strategy of the company and act as a flexible tool to achieve their goals, as the basis for strengthening the competitive position of the company. In this light, the financial strategy of the company becomes a necessary condition for competitiveness and sustainable growth.

Poor drafting of the provisions of the modern theory of financial management in relation to the characteristics of the formation of a competitive position within the financial, strategic management and the absence of such an assessment as strategy development in emerging markets, lead to the situation when it is necessary to examine the issue from the perspective of the problems of the formation process of the financial strategy. Financial strategy thus comes out to be a process of managing its capital structure through the relationship of its main components: the dividend, investment strategy and funding strategy.

The development of a financial strategy in emerging markets has a number of features. The researchers raise a question of whether this type of markets has any specific factors and concepts, or it is possible to apply to the capital structure of companies in developing countries theoretical concepts used by companies in developed countries. In addition, the study of the structure of capital in emerging markets allows to look at the processes of capital structure adjustments that occur as a result of changes in the factors in the development of markets [13].

The study of emerging markets is largely confined to the analysis of financial markets, the availability of funding and forms of political and legal constraints.

Chakraborty says that the capital market in India began to develop only after 1992. Further, in the period from 1995 to 2008 there were reforms in the banking sector in India. As a result, the empirical data confirm significant changes in the company's capital structure [2].

Delcoure, exploring the transition economies such as Russia, Slovakia, Poland, Czech Republic, says that in these countries the ratio of stock market capitalization to GDP ratio is below 3%, which is significantly lower than in developed countries [5].

Wu and Yue - based on the study of the capital market of China, conclude that there is almost no corporate bond market in China (less than 1% of GDP), there are significant restrictions on the admission of companies to the IPO, the demand for bank loans is much higher than supply [14].

Cspedes, Gonzlez and Molina notice that, compared to the United States, companies of Latin America have less benefit from tax shields [4].

In most developing countries, accounting policies and disclosure requirements remain low. In addition, the number of analysts covering the company, in developing countries is substantially less than in developed countries. So, Rajagopal notes insufficient analytical service banks in India and high levels of information asymmetry [10]. Lopez and de Alencar say about an uneven level of disclosure of information by companies in Brazil [8].

In emerging markets, there is a negative relationship between profitability and debt, a positive between debt and growth opportunity, at the same time the theory of the pecking order is put in practice [3].

Thus, it is possible to identify the characteristic features of imperfect markets that have a significant impact on the company's financial strategy:

– limited access to the capital;
– high information asymmetry and agency costs;
– high macroeconomic risks for investors;
– inefficient ownership structure of the company (a large share of public participation, a problem of a high concentration of ownership);
– low level of corporate governance.

Financial market in developing countries is significantly different from the market of developed countries. Many managers argue that the implementation of forecasting and long-term planning (as a fundamental part of the financial strategy) under underdeveloped financial market is very difficult. The reason lies in the lack of efficiency of the market and a high level of risk.

2. Theory

Obviously, the development of financial strategy should be carried out in full accordance with the strategic objective of maximizing the market value of the business and in conjunction with the corporate strategy of the company, which it is a part of.

Structural-quality contours of the economy, that have come out after the crisis of 2008, are a strong evidence in favor of the thesis about the maintaining of the priority of the financial sector, what actualizes the problem of the formation and implementation of the financial strategy of large corporations necessarily taking into account the following aspects [1]:

– Financial strategy is closely correlated with the general and determines its timing.
– The formation of a financial strategy for the post-crisis stage of development of the global economy is shifting from purely Instrumentation field into the methodological.
– Financial strategy determines the production of value, and therefore must take into account its partial absence of the object and shift towards innovative technologies.

Key and typical issues of the main stages in the formation of the financial strategy in emerging markets are shown in Table 1.

Table 1: Issues in the formation of the financial strategy in emerging markets

Stage characteristics	Typical issues of companies in emerging markets
Defining the strategy period	- Lack of clear relation between general and operational financial strategy; - The period of the financial strategy is not correlated with the terms of an overall corporate strategy; - Current financial management is carried out without the strategic planning of these activities;
Formation of strategic financial goals	- Lack of alignment of goals and justification of targeted strategic standards that are being used; - Weak association of corporate and financial strategy; - Every top manager of the structural unit sees different phenomena and consequences speaking about financial strategy and interim goals;
Identification of the most important financial indicators	- Lack of distinction of scorecard and regulations, without regard to the specific type of business and the specific features of the company
Development of financial policies	- Unjustified use of improved indicators - The predominance of qualitative analysis, what makes it difficult to justify certain decisions; - Improper separation of planning and management in multi-level nature of the strategic financial activities;
Monitoring of the implementation of the financial strategy	- Excessive congestion of controlling system because of the lack of transparency in internal and external reporting - Lack of skills for proper analysis of the numerical data

In addition to the problems identified in the stages of development of financial strategy, not of a less importance are the typical problems of implementation of financial strategies in emerging markets, which generally include:

- The incompetence of the staff and management: resistance to change, due to the implementation of the financial strategy, a lack of understanding of its importance and an inability to structure the strategic objectives, as well as the lack of necessary skills.
- Implementation of financial strategies in isolation from anti-crisis activities. In the face of uncertainty in emerging markets companies, as part of establishing the strategy should insure themselves against the risk of insolvency and financial instability.
- Presence of agency conflict, when the leaders prefer to maintain control over the company to the detriment of its strategic development [7].
- Focusing on short-term results rather than long-term financial goals.

Specific integrated problem of implementing financial strategy is the need to select strategy respectively in the field of dividends, investment and financing, that would ensure maximum capitalization.

3. Results

The solution of described problems largely depends on the specifics of the company and its strengths and weaknesses. Nevertheless, certain universal methods to improve the competitive position of the company in a strategic aspect can be used in the emerging markets as a compromise that has significant positive impact on the company's capitalization. In the context of the application of such models there are two possibilities there: either partially and simultaneously mitigate problems on the stages of development of financial strategy, or partially compensate them. However, it does not negate the need for a comprehensive work to overcome the above problems of formation of financial strategy in emerging markets.

The classical model of financial strategies is the matrix of J. Franshon and I. Romance, that defines the ratio of investment opportunities the company has and its available (used) debt financing in the dynamics of the natural development of the company. The matrix of High School Financial Management reflects the ratio of the rate of sustainable growth of the company and the value creation process in the long run.

As an option of a model of formation of financial strategy in conjunction with the integrated assessment of the competitive position, was developed and tested a new type of three-dimensional matrix showing the relationship of the financial strategy of investment, financing and dividend policy, fully taking into account, in contrast to the classical models, industry-specific activities (Figure 1).

The formation of an optimal capital structure is possible, but only for a particular company. Recommendations for some universal capital structure are far from reality [9]. At the same time, the use of models of financial strategies just means that there is an individual approach to each company and the ability to model the optimal capital structure.

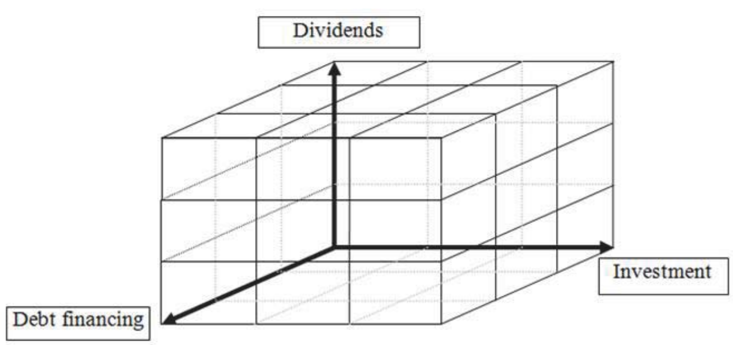

Fig. 1. Matrix of Optimal Capital Structure

There can be two options to form this matrix there: either to do an econometric research and designation of the normative values of these parameters of the matrix on the basis of certain reasons and theories for the purpose of distribution companies by quadrants, or, to compare the results of companies that are competitors with each other and caught in one sample.

The sensor was tested in the chemical and petrochemical sectors of the Russian economy. In 2007 and 2008, 11 companies out of 17 had a favorable position; in 2009, only 8 companies in 2010 - 10, 2011 - 9, 2012 - 10: even in comparison with each other companies and their distribution in terms of Equiprobable matrix, there are deviations from the average value of a favorable position, depending on the situation prevailing in the emerging market. 2009 was marked by the largest decline in production and the stagnation of the Russian market for the entire period of the global financial crisis, the beginning of which took place in 2008.

You can also consider the relationship between the parameters underlying the matrix we proposed, with three indicators of value (Table 2). The selection of matrix parameters in relation to different value parameters and further qualitative assessment contributes towards a more accurate assessment of the competitive position of a public company through the prism of financial management.

It should be noted that the rate of MBR 1, based on the accounting estimate, is calculated by the formula 1:

$$\text{MBR 1} = \frac{\text{Market capitalization}}{\text{Undistributed profit+Equity capital}} \quad (1)$$

Indicator MBR 2, reflecting the ratio of market and book value, is calculated in the following way (formula 2):

$$\text{MBR 2} = \frac{\text{Market capitalization}}{\text{Book value}} \quad (2)$$

Where: MBR (Market-to-Book Ratio) is a company's market price in relation to its book value.

Table 2: Relation of matrix parameters and cost indicators

Cost indicators	MBR 1	MBR 2	Economic value added
Take into account	Negative impact of net financial leverage on the cost of the company. Positive impact of the growth of debt capital in relation to net income. Positive impact of dividend payments of all classes of shares.	Negative impact of the net and the balance financial leverage on the cost of the company. Positive impact of dividend payments.	Positive impact of net financial leverage on the cost of the company. Positive impact of efficiency and size of investments on the market assessment.
Do not take into account	The influence of the investment strategy on the cost of the company	The influence of the investment strategy on the cost of the company	The influence of the dividend payments on the cost of the company

4. Conclusions

Thus, the development of financial strategies in modern conditions is a prerequisite for the competitiveness of companies and the long-term sustainable growth. The process of developing a financial strategy in emerging markets is characterized by the absence of a comprehensive strategic analysis and preliminary assessment of the expected effectiveness of the implementation of the strategy; an integrated assessment and modeling of the competitive position of companies in the areas of financial management are almost never used, what cannot be fully compensated by the systematization of certain financial ratios; often there are no mechanisms to support implementation of the strategy there.

In our work we propose to add to the standard process of formation of financial strategy in emerging markets such stage as a comprehensive assessment of the strategic competitive position of companies in the area of finance (in the developed matrix of optimal capital structure). Such an assessment does not only diagnose the current situation, but also gives you the opportunity to shape the future position of the company.

Further study of the problems of development and implementation of financial strategies of companies in emerging markets are seen promising and may be based on the development and testing of new strategic financial models that can have: an assessment of ratio «risk-liquidity», an analysis of financial security, an assessment of the impact of market share on the main areas of financial management, a study of the relationship of derivative financial instruments and the value of the company in a strategic aspect, a definition of the place of a strategy to improve financial management in the hierarchy of financial strategy, an analysis of the strategic implications of structural reforms.

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