OPTIMIZING THE SOURCES OF SELF-FINANCING AS A PREREQUISITE FOR MAKING SOUND MANAGERIAL DECISIONS

NIKOLINA KELESHOVSKA – PAVLOVSKA

E-mail: nine_p_1999@yahoo.com

I. INTRODUCTION

The most important source of self-financing is retained earnings, but unfortunately it is the most limited one. Therefore, one of the roles of management is the adoption of appropriate decisions to use the cheapest source of funding and accounting policies for the treatment of sources of funding. If enterprises use their own sources of funding, positive effects can be observed in the conduct of financial policies in a way that a high level is financial independence in making financial decisions as well as flexibility in the conduct of financial policy and profit distribution. However, the basic precondition for providing and use of sources of self-financing is the realization of profits, while profits directly depend on the profitability of the business entity. Consequently, the business entity that operates profitably fulfills the conditions for self-financing. If the enterprise is self-funded, it eliminates the risk of insolvency, because if it uses foreign funds to finance there is risk of not being able to return them within the stipulated period and amount, in accordance with agreed terms.

Amid the global economic crisis problems of providing adequate sources to fund the operations of business entities are becoming more common. If the business entity is capable of meeting their funding needs fully or to a large extent by using their own sources, then they get a significant competitive advantage and an opportunity to grow by reducing financing costs and minimizing risk.

Self-financing is the cheapest form of financing the process of reproduction, because the enterprise does not have to repay interest, nor it has obligation to repay principal , which is not the case with foreign funding sources. This way of financing allows a high degree of financial independence when making financial decisions as well as financial flexibility in conducting policy and profit distribution. There are more available sources for self-funding of businesses. The ability to utilize them fully guarantees business success. Therefore, every business entity should develop an appropriate strategy for self-financing, which will serve as a tool for sustainable development.

From the reached decisions on the use of some type of source of self-financing, a new issue is introduced, in terms of adoption of appropriate accounting policies or specific principles, bases, conventions, rules and practices applied by the enterprise in preparing and presenting items in financial statements relating to the sources of self-financing.

The problem of providing adequate sources of self-financing of enterprises is present in businesses that operate in economies that do not have a developed capital market, but also in enterprises that have developed capital market, where theoretical approaches are fully realized in order the capital markets to function perfectly.

II. PRACTICAL RESEARCH ON THE REASONS LEADING TO BAD MANAGERIAL DECISIONS DUE TO UNUSED SOURCES OF SELF – FINANCING

- Active management of working capital by business entities is unfortunately not used satisfactorily. The reasons for this can be found in two groups of factors. In the first group of factors that have a negative impact on active management of working capital can be: credibility, financial discipline of partners, liquidity, inflow of money and payment of obligations, solving problems and conflicts. Managers of business entities also find difficulties in the management of working capital, which prevents adequate planning of inflows and outflows, as well as a precise calculation of the costs that arise from working capital. The second group of factors that have a negative impact on the management of working capital, and hence have problems with financing of business entities, is the lack of tools for managing working capital. First of all, the lack of factoring or the possibility of early payment of regular receivables for a certain fee and time contracts, that is the purchase of currencies, raw materials and the rest on a future date at a fixed rate or prices. The modern working capital management procedures include complex models for determining the adequate levels of inventory, maintaining the periods of collection of receivables and payment of obligations at a satisfactory level, optimal allocation of the liquid assets in the short term for providing a satisfactory yield, attenuation to a minimum of losses arising from inadequately engaged capital in working capital, covering the risks of price changes and exchange rates, hedging, etc. All

these operations, if they are adequately carried out and in circumstances where they can be implemented, facilitate the financing of the business activities of the business entities. In contrast, in circumstances where application of these models and practices is not possible in reality due to a series of factors, they additionally complicate or negatively affect the processes of selection and use of different sources of funding. In this case, bad management of the partners' claims or financial indiscipline leads to a situation that business entities, instead of using the planned internal sources of financing, use external sources of funding, which are an expensive source of funds.

- Liquidity problems, delay in collection, difficult access to loans - are the main problems that business entities have for a long time. It also affects the maintenance of working capital, which has a crucial influence on maintaining the financial condition of the business entity.
- The practice has shown that the relationship between own and borrowed capital is determined by: the composition of assets, the rate of inflation, the rate of profitability and the degree of liquidity. With the distortion of their ratio, that is, with greater representation of the borrowed capital, a greater indebtedness of the business entity results in the decrease of its independence, stability and security. It is a prerequisite for management to reach additional bad business decisions that jeopardize the successful operation of the business entity.
- Neglecting the importance of having a separate organizational unit with experienced and educated employees, who will work on the issues of financing. In most cases, this function is marginalized, and it is often an integral part of another organizational unit (such as accounting). In small business entities, the financial activities are carried out by the owner, in middle-sized business entities by financial services, and in the major business entities - by the financial sector. Depending on the circumstances in which the business entities are, businessmen tend to accomplish their business tasks with fewer employees, not realizing the seriousness of the financial function. Therefore, in practice, there is no analysis of alternative sources of funding, such as primary and secondary capital markets. At a time when access to finance is aggravated, the importance of a good team is crucial because it should find the best way to secure funding. A bad funding decision reached by unprofessional staff would have bad implication on global managerial decisions, and then the business entity's success might be called into question.
- Insufficient knowledge of the concept and the process of financing. In practice, the majority of managers believe that financing involves only providing financial resources to finance their operational or investment activities. The lack of understanding of financing as a dynamic process leads managers to think only about how to collect money, and not to think about the following activities:
  - investment,
  - return of the invested money and
  - reconciliation of sources of financing with investment.
- Recognizing Bootstrap funding as the only and the most affordable source of financing for small business entities. Most often, it is personal savings of the owners or loans without interest from relatives and friends who invest in the business entity, or the money they receive after the activities to improve the payment system. Small business entities have difficult access to credit, as most have a problem with solvency and securing the loan. The income is only fictional and it is not used as a source of self-financing in reality.
- Ignorance to the characteristics of the sources of self-financing. Most of the managers of business entities think that self-financing only refers to the profits intended for reinvestment. The management of the business entities has a lack of knowledge of the opportunities offered by the financial markets. They do not know the conditions for issuing securities through a public or private offer, and they are convinced that it is a complex and costly procedure and that it is not for them. Furthermore, they are not confident in their own success and they are not prepared to publish transparently their financial reports. The biggest fear among the management is the change of ownership in the business entity, or that the company may be taken over when raising capital by emission of new shares.
- In underdeveloped economies, productivity and cost-effectiveness are weak points and they are the reason for incomplete utilization of the possibilities for self-financing from the realized profits of the business entities. Businesses, in order to survive in an environment where competition is more pronounced and sharper, must create strategies that will contribute to their more efficient operation. Therefore, particular attention should be paid to improving the national competitiveness and productivity, through undertaking microeconomic reforms, reducing the costs of doing business in small and medium-sized businesses, and reducing tax burdens.
- The poor state of the Stock Exchange in underdeveloped economies is another reason for not using the possibility of self-financing. The lacks of money, the financial crisis, the worsening economic environment, the absence of regional investors are all part of the reasons for

the poor state of the stock market. However, there is one strange situation where business entities show excellent results, but the prices of their shares fall, which means total indifference and no active trading. The capital market is full of small and disinterested shareholders who cannot influence the decisions of managers and irresponsible managers. As long as domestic companies find it easier to borrow from banks, than to invest their money in securities, the stock market will stagnate.

III. RECOMMENDATIONS FOR OPTIMAL UTILIZATION OF SOURCES OF SELF – FINANCING IN ORDER TO REACH SOUND MANAGERIAL DECISIONS

There are numerous challenges and different alternatives for the managers in making business decisions. If it a decision to finance new capacities, to invest in new products or to access foreign markets, managers must have managerial tools, strategies, experience and knowledge. In order to have optimal utilization of the sources of self-financing, managrs should respect the following principles in order to have a high level of self-financing and thus a guaranteed business success of the business entity. Respecting the principles is a prerequisite for optimizing the sources of self-financing.

3.1.1 The principle of security requires financing of those business ventures in which the money will be reliably recovered and the degree of risk is the lowest. When a business invests cash in its own business, then it faces the risk of achieving a negative financial result that is growing in conditions of decline in production, sales and prices. The risk can be reduced by reducing the fixed costs of financing (interest), reducing the depreciation, as well as by increasing the amount of own sources of financing. When a business invests cash in other business activity, the risk of impossibility of collection of receivables both long-term and short-term is encountered. The risk can be reduced by prior analysis and assessment of solvency and creditworthiness of potential debtors.

3.1.2. The principle of stability requires the management to train a business entity to finance simple reproduction from its own sources and with borrowed resources to finance extended reproduction, or development, while minimizing the risk to creditors. The stability of funding is calculated by a coefficient, where long-term assets are divided by long-term sources. The business entity should keep that coefficient smaller than 1, because in that case the long-term assets are financed by long-term sources and also from those sources, one part of the short-term assets is financed and that is the working capital.

3.1.3 The principle of liquidity. The liquidity problem of the assets refers to short-term financing which is the management of working capital: money, market securities, receivables and stocks, as well as administration of short-term liabilities. The principle of liquidity can be observed in both narrower and broader sense. In a broader sense, liquidity is the ability to convert non-monetary assets into money and vice versa. The most important measure of liquidity is the relationship between current assets and current liabilities. Current assets are any assets that can be converted into cash over a year (money on a gyro account, inventories, purchases, securities, etc.) and current liabilities must be paid with the cash during the year such as: obligations to suppliers, liabilities to the state, liabilities to shareholders, etc. If the current assets cover the current liabilities in a ratio of 2:1, then all creditors can expect recovery of their receivables. In a situation when the relationship between current assets and current liabilities is ideal, the management can still lead the business to insolvency if it finances capital investments from short-term sources. Liquidity is provided by matching cash inflows and cash outflows on the basis of matured liabilities of the business entity. Measurement of short-term liquidity is the first test of the financial position of the business entities in terms of whether they will have enough money in the near future to service the short-term liabilities that are due.

3.1.4 The principle of solvency is the ability of the business entity to pay its obligations within the deadlines. The solvency ratio is calculated when the available cash is placed in relation to the total liabilities. When the coefficient is greater than 1, then the business entity is solvent. Insolvency is spreading vertically and it is transferred to other business entities when debtors do not pay their obligations to creditors. Liquidity and solvency are interconnected and non-liquidity can cause insolvency.

3.1.5 The principle of profitability is the ability to achieve as much financial result as possible with as little investment as possible. When the business loses, its operation is unprofitable. Profitability is an increase in invested funds while maximizing profits in the long run. The profitability can be measured by means of the rate of return on equity and the rate of return on total equity:

The rate of return on equity is calculated when the net profit is divided by its own equity. The obtained percentage shows the degree of return on equity financing.

The rate of return on total equity is calculated when gross equity is divided by total equity. The obtained percentage measures the level of financing from the total capital.

3.1.6 The principle of flexibility. This principle indicates the ability of the business entity to adapt to different financing conditions. While adapting, it is particularly important:

• the ability of the business entity to obtain additional money; - own sources are provided through shares, stakes, accumulated profits, depreciation, etc. while

foreign sources are provided through bond issue, long-term loans, etc.

• the ability to repay the debt ahead of time - When a business has a surplus of money, it should not pay interest on borrowed money, because interest reduces financial result and cost-effectiveness. The principle of flexibility presupposes the payment of the debt or part of the debt ahead of time and thus minimizes the payment of interest.

3.1.7 The principle of autonomy of a business entity comes to light when a business entity is functioning without the use of other financial assets. This means that the business has sufficient own funds to cover its needs. The business entity is financially independent, when it is financed from its own sources. In that case, the risk of losing independence in decision-making is eliminated, and the risk of insolvency is eliminated because the entity has no obligation to return borrowed capital. The degree of dependence also affects both profitability and distribution policy, because the business entity cannot increase its equity by issuing shares if it is insufficiently cost-effective. However, the business entity must not avoid financing through borrowing at all costs.

The most important indicator by which the principle of independence is quantified is the following: Indicator of independence = own capital / total sources of financing.

CONCLUSIONS

Sources of Self-Financing are Divided Into Three Groups:

- Internal sources of self-financing, which can occur in the following types: depreciation, principal payment from long-term placements, long-term provisions made against the total income, accumulated net profit and effects of revaluation reimbursed from the total income, external sources of self-financing, presented in the following manner: self-financing by issue of shares, lasting deposits from third parties, invested capital from owners of foreign business entities and sale of long-term bonds above the nominal value, and
- Hidden forms of self-financing. Hidden self-financing is called because latent reserves are not an integral part of the balance sheets and are a consequence of underestimation of the property or overestimation of liabilities

Self-financing has many advantages over other types of funding sources. This contributes to increasing the independence and efficiency of operations, which increases the quality of managerial decisions in the direction of growth and development of the business entity, and these advantages are:

-Free form of funding. Self-financing is the cheapest form of funding for the reproduction process. This form of financing does not entrust the business entity with interest, nor with the obligation to return the principal, which is not the case with foreign sources of financing;

- Proof of creditworthiness;

-Greater financial independence and flexibility in the conduct of financial policy and profit distribution policy;

-Depreciation and accumulation represent the most reliable and stable own sources of financing. These eliminate the risk of insolvency, while the increase in foreign assets increases the risk of insolvency and

-They are permanently tied to the business entity-they do not have a precise maturity date.

In addition to the given advantages of self-financing, there are certain disadvantages too. Besides the difficulty in securing the sources of self-financing and their limitation, the following deficiencies in self-financing also exist:

- The difficulty that arises when covering the short-term and long-term needs of business entities with funds that can be provided through self-financing;
- Financial resources from sources of self-financing are more economical than other sources of funds and can therefore be invested in less profitable projects, which is not justified for the development of the country, and
- The increase in the price of products and services based on accelerated depreciation leading to increased production costs.

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