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IMPROVING METHODS FOR FINANCIAL RISK MANAGEMENT AT AN ENTERPRISE

УДОСКОНАЛЕННЯ МЕТОДІВ УПРАВЛІННЯ ФІНАНСОВИМИ РИЗИКАМИ НА ПІДПРИЄМСТВІ

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In the conditions of modern market relations, one of the most important problems facing organizations is to determine the possibility of occurrence, assessment and ways to reduce economic risk. In the conditions of fierce competition the risk acquires independent theoretical and applied value as the most important component of enterprises administrative activity. Risk is an objectively inevitable element of any business decision due to the fact that uncertainty is an inevitable characteristic of business conditions. The decision taken by an entrepreneur almost always involves a risk resulting from a number of uncertainties not foreseen in advance. Business is becoming more challenging, the amount of available information is growing, markets are globalizing, and as a result – financial risk management is becoming one of the main factors in the company development.

Everyone involved in risk management understands that it is impossible to predict all the situations that can hit the business. There is no clear answer whether the current situation in the world related to Severe Acute Respiratory Syndrome Coronavirus-2, the economic phenomenon "Black Swan" ("TBS" – N. Taleb theory) or it realized a risk that could be foreseen and prepared for. However, one can say unequivocally that the whole world was not ready for the pace and scale of the Severe Acute Respiratory Syndrome Coronavirus-2 pandemic, and, in particular, Ukraine. Neither were they prepared for a crisis of this magnitude, and most companies, moreover, now many are not even prepared to disclose their actions in a situation of great uncertainty.

According to the State Statistics Service, in 2020 the share of unprofitable enterprises was 38.7%, which was 12.3% more than in 2019 – this was due to the emergence of Severe Acute Respiratory Syndrome

Панченко М.О., Донецькова В.А. Удосконалення методів управління фінансовими ризиками на підприємстві. Оглядова стаття.

В статті докладно розглядаються усі найважливіші аспекти фінансового ризику підприємства та його мінімізація. Відзначено, що в літературі відсутній єдиний підхід до визначення даного поняття. Однак практично всі підприємства стикаються з необхідністю мінімізації фінансових ризиків, авторами визначені основні способи їх мінімізації. Запропоновано нову класифікацію фінансових ризиків відповідно до сучасної економічної проблеми, пов'язаної з пандемією. Більш детально як одні з популярних за кордоном та перспективних для України способів мінімізації ризиків розглянуто страхування та диверсифікацію.

Ключові слова: фінансовий ризик, страхування ризику, диверсифікація, мінімізація ризику, класифікація фінансових ризиків, ризик-менеджмент

Panchenko M.O., Donetskova V.A. Improving methods for financial risk management at an enterprise. Review article.

The article examines in detail all the most important aspects of the enterprise financial risk and its minimization. It is noted that in the literature there is no single approach to this concept definition. However, almost all the enterprises face the need to minimize financial risks, the main ways to minimize them are identified by the authors. A new classification of financial risks according to the current economic problem associated with the pandemic is proposed. Insurance and diversification are considered in more detail as one of the most popular and promising ways to minimize risks abroad.

Keywords: financial risk, risk insurance, diversification, risk minimization, financial risks classification, risk management

Coronavirus-2, which due to quarantine measures worsened the situation as enterprises and the country as a whole [10]. The consequences of the pandemic were: a reduction in GDP, complete or partial shutdowns, a sharp rise in unemployment, rising inflation, declining household incomes – this led to the enterprises crisis and may further cause their bankruptcy if appropriate measures to overcome this phenomenon are not taken. In addition, the pandemic has already caused a snowball effect, the enterprises closure to quarantine has led to dissolving small and medium-sized businesses, and thus a reduction in effective demand, which leads to further bankruptcy of small enterprises.

At the time of quarantine, 74% of companies included risks in the risk register that had been realized in the last few months, but only 16% of companies had in their register a risk similar to the situation with Severe Acute Respiratory Syndrome Coronavirus [10].

Those companies that go bankrupt will no longer need a risk assessment. And those ones who will be able to overcome the financial crisis will be divided into two main camps: those ones who are lucky and effective experts. The first one are those who for one reason or another are just lucky (formed random balances in warehouses due to poor sales or errors in marketers' calculations, random stocks of currency in accounts, unsigned or transferred contracts, etc.). And they had a safety margin. The second ones are those who have made risk-based decisions and taken the right steps at the first signs of an approaching threat. However, luck is unpredictable, and effective risk management is always relevant.

Analysis of recent researches and publications

Among the scholars who made a scientific contribution to the of risk theory development we can highlight the following: I.A. Blank, Dzh. Keins, Dzh. Khempton, I.T. Balabanov, V.V. Vitlinskyi, L.H. Sharshukova, V.M. Hranaturov, T.A. Bondar, D.A. Vanina, D.O. Hrytsyshena, M.H. Lapusta, V.V. Yevdokymova, L.H. Lovinskoi, Ya.V. Oliinyk, O.K. Pylypenko, S.I. Nakonechnyi., L.I. Donets, E.V. Vyliezhhanina, I.S. Hryhorian, O.A. Havrysh, V.A. Kavun, T.V. Babaiev, A.O. Kocharova, H.P. Honchar, I.O. Horho, E.A. Utkin, O.M. Donets, A.A. Zhyhir, D.O. Frolov, O.A. Zorina, M.F. Ivashov, O.N. Kostin, O.V. Orlyk, V.V. Tyshchenko, O.I. Tyshchenko, H.O. Tkachuk, V.V. Loiko, M.Iu. Boieva dedicates their works to to the study of the financial risk features and methods of managing them.

The aim of the article is to define and consider in detail the concepts and essence of the enterprise financial risk, as the enterprises effective development is determined by the extent to which managers have the tools to assess risks and identify ways to minimize them. The possibility of survival and the enterprise effective development in dynamic and often unfavourable conditions depends primarily on the choice of an effective strategy.

The main part

In current circumstances enterprises face many different risks, one of which is financial risk. Ignoring or dishonest treatment of this type of risk can lead to significant financial consequences, and in some cases, even bankruptcy.

According to E.A. Utkin and D.O. Frolov, financial risk is the level of financial losses, which is expressed in the possibility of not achieving the goal, in the uncertainty of the expected result, in the subjectivity of the expected assessment [11].

In turn, M.H. Lapusta and L.H. Sharshukov refer to financial risk as the probability of unforeseen financial costs (reducing expected profit, income, loss of part or all of the capital) in the case of uncertain conditions of the enterprise financial activity [6].

I.O. Blank considers financial risk as a result of choosing an alternative financial solution, which is aimed at achieving the desired result of financial activities with the probability of economic loss (financial loss) due to the uncertainty of the conditions for its implementation [2].

Based on the analysis of existing approaches and different authors' ideas, we highlight the main features of the financial institutions risks:

- risk arises in a state of uncertainty,
- the result of the risk is the consequences of adverse results (losses, lost profits),
- the risk inevitably accompanies the financial institution activities.

Analysis of the definitions of "financial risk" allows us to make the conclusion that among economists there is no consensus on what is still a financial risk. In our opinion, after summarizing all these interpretations and taking into account the above-mentioned characteristics, we can assume that the enterprise financial risks are characterized by possible negative consequences in the form of loss of income, capital, financial results of an enterprise, in a situation where the enterprise financial environment is uncertain.

As part of the main classification features of the enterprise financial risks are the following:

- the source of risk (systematic (market) risk – is characterized by the probability of financial losses associated with adverse changes in various types of financial markets;
- non-systematic (specific) risk – is the probability of losses associated with inefficient activities of a particular enterprise);
- form of financial risk (market – interest, currency, price; specific – credit, investment, innovation, deposit, reducing financial stability, insolvency);
- characteristics of the risk assessment object (risk of a separate financial transaction; different types of financial activities; the enterprise financial activities as a whole);
- a set of researched instruments (individual financial risk; portfolio financial risk);
- complexity of financial risk (simple financial risk (e.g. inflation risk);
- complex financial risk (e.g. investment project risk);

- the nature of the possible financial consequences of the risk (risk that causes only economic losses, risk that entails lost profits (when the enterprise cannot perform the planned financial transaction);
 - risk that entails both economic losses and additional income (e.g. the risk of real investment project, the profitability of which in the operational stage may be lower or higher than the estimated level);
 - the ability to predict risk (predicted (e.g., price, interest);
 - unpredictable (e.g., risks of force majeure);
 - possibility of risk insurance (which is insured, which is not insured) [3].
- The nature of the risk in time:
- constant financial risk is characteristic of the entire period for the financial transaction;
 - temporary financial risk (e.g. insolvency risk) arises at certain stages of the financial transaction;
- the level of implementation probability;
 - with an average level of realization probability;
 - with a high level of realization probability;
 - the level of realization probability which cannot be determined);
 - the level of possible financial losses on risk (losses do not exceed the estimated profit amount);
 - critical (losses do not exceed the estimated amount of gross income);
 - catastrophic (losses are determined by partial or complete loss of capital) [9].
- The effectiveness of risk management is largely determined by the risk classification. As a rule, financial risks are divided into two types, which in turn are divided into subspecies (Fig. 1). Therefore, the two main types are:
- related to the purchasing power of money;
 - related to investment.

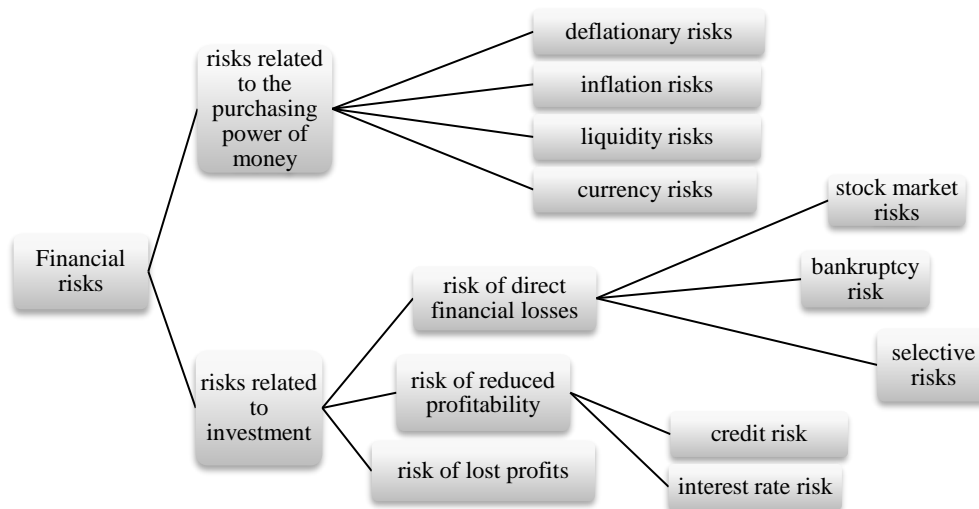


Figure. 1. Types of Financial Risks

Source: authors' own development

We propose to combine the existing risks in accordance with the current economic problem associated with the pandemic, which is a new risks classification. These risks may be triggered by companies' attempts to emerge from the crisis caused by the global economic downturn.

Thus, we see that the first group includes such risks as:

- inflation risk – in this case, with rising inflation, cash income depreciates in terms of real purchasing power faster than growing. In such circumstances, the entrepreneur incurs real losses;
- deflationary risk is the risk that as deflation increases, prices fall, economic conditions deteriorate and incomes decline;
- currency risks are associated with changes in the exchange rate of one foreign currency against another in external economic, credit and other foreign exchange transactions;

— liquidity risks are the risks of possible loss in the securities sale or other goods due to changes in assessing their quality and consumer value.

We also see that the second group of risks includes the following:

- risk of lost profits is the risk of indirect financial loss as a result of failure or failure to take any action;
- reduced risk of profitability is the risk that may arise as a result of lower portfolio investments, investments, interest rates on loans and dividends. Such investments are associated with the investment portfolio formation through the acquisition of securities and other assets. Reduced risk of profitability includes the following types:
 - interest rate risk is the risk to return arising from adverse interest rate fluctuations that lead to higher interest costs or lower income from investments and income from loans.

- credit risk – assumes the probability of financial loss to one enterprise (conditionally party 1 of the agreement on the financial instrument) due to the fact that another company (party 2) for some reason will not be able to fulfill its obligations. Credit risk can also be a direct risk of financial loss;
 - risks of direct financial losses include the following types: stock market risk, selective risk, bankruptcy risk;
 - stock market risks are risks that represent the risk of losses from exchange transactions. These risks include: the non-payment risk in commercial matters, the non-payment risk of commission of the brokerage firm, etc;
 - selective risks are the risks of incorrect choice of the capital investment method, type of securities for investment in comparison with other types of securities in the investment portfolio formation;
 - bankruptcy risk or insolvency risk is the danger of the wrong way of investing capital, the complete loss of the entrepreneur's equity and its inability to pay its obligations.
- When identifying the most dangerous risks, the market participant takes all measures to reduce them.

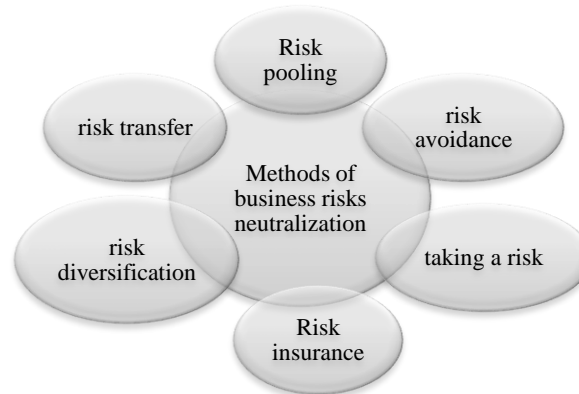


Figure 2. Means of Reducing Financial Risks
Source: compiled by authors on materials [1].

There are several main ways (Figure 2):

- risk avoidance is a way of protecting capital, one of the most popular. Ability to avoid losses that are associated with risks of financial activities;
 - taking a risk – the investor is preparing for material compensation for probable losses, but in the absence of resources, taking financial risks can lead to a reduction in business (reduced investment volume);
 - risk transfer - all or part of the financial risks are transferred to stronger business partners who are able to effectively eliminate the trouble;
 - risk insurance is an agreement execution that provides for the compensation payment by the insurance company in case of full or partial loss of profit. It is possible to insure against bankruptcy, unforeseen costs, reduction or cessation of production processes, coverage of court costs;
 - risk pooling is one of the most effective ways to reduce risk. The company solves problems by involving business partners and individuals who are interested in overcoming the situation. The overall financial risk is shared between several economic entities;
 - risk diversification is the distribution of capital between several unrelated areas. Competent diversification allows to reduce risks in conducting investment activities. The main types of diversification include:
 - financial market diversification;
 - currency basket diversification;
 - diversification of the deposit portfolio;
 - customer-centric diversification;
 - securities portfolio diversification;
 - the company financial activities diversification [1].
- Choosing a particular method of risk management is based on the risk ranking results, which allows to identify priority risks of the position of the need for management.
- Thus, measures aimed at reducing inflationary risk are important:
- the market price formation and controlling the level of production costs;
 - increasing the labour productivity by means of automation of production and introduction of new technologies;
 - marketing research (it is necessary to avoid projects whose payback period can be long);
 - sound financial policy development (minimization of cash and receivables) [5].
- Currency risk management can be done through:
- currency assets diversification in the organization;
 - restrictions on using currencies with unstable exchange rates;
 - contractual restriction on export transactions in a certain currency;
 - for the purpose of more exact forecast of this or that currency in the long run the technical analysis of the trades course on the currency exchange for a certain term is applied;

— currency risk hedging through currency futures, currency options and "swap" operations [8].

Risk management of deflationary risks is aimed at:

- diversification of services provided to increase the services share that have the highest demand in the market;
- limiting the services provision with a minimum margin required in technical terms for the entire project of services;
- contractual restriction under the terms of contracts to change the price of work in progress in accordance with the transfer legislation;
- monitoring of prices under tender contracts in order to prevent the conclusion of contracts with suppliers above market prices [7].

Methods aimed at credit risk management:

- investments diversification in the enterprise;
- limiting the use of loans and borrowings at high interest rates;
- Contractual restrictions on the provision of long-term loans and credits to unreliable counterparties;
- use of factoring to reduce financial risk;
- the solvency assessment of the counterparty on loans and borrowings.

The methods of liquidity risk management and rising costs risk are as follows:

- diversification by contractors for competitive procurement in tenders for the suppliers' selection;
- limitation of administrative costs and point-of-sale costs;
- creating a separate reserve fund, which can be used for projects with new suppliers or in the event of an unexpected increase in prices for the necessary equipment [5].

Let's consider the most interesting means for us to reduce financial risks, namely insurance and diversification, which are currently actively used in the global financial market. Financial risk insurance is the enterprise protection by insurance companies in the event of an insured event. It is accepted to highlight internal and external insurance of financial risks. External insurance means avoiding the enterprise risks by transferring the insurance company risk. It is carried out in two forms: mandatory and voluntary [8].

Domestic insurance is called self-insurance, the essence of which is that the entrepreneur seeks additional material benefits and prefers to insure themselves, thereby reducing the capital expenditure. This type of insurance is a decentralized reserve fund, created both in kind and in cash.

Taking into account the current experience of other countries, one of the mechanisms of self-insurance is the captive insurance companies creation, i.e. insurance companies that belong to the group of non-insurance organizations - industrial, industrial-financial, financial groups, etc. - and insure the whole group risks.

A captive insurance company allows to invest insurance funds within a joint business unit, keep profits within it, get some tax benefits (some countries' laws provide for them), avoid bureaucratic

delays in obtaining insurance [2]. However, this method has a significant disadvantage: this type of activity adds a new risk to the group – the deterioration risk of financial results associated with large, catastrophic risks, due to the actual redistribution of losses between the captive insurance company and the structural elements of the group. For this reason, when creating a captive insurance company, the risk manager should carefully evaluate all the advantages and disadvantages of using this self-insurance mechanism. Self-insurance, as a risk management method, allows to strengthen the system of incentives for preventive measures; improve the procedure for compensation; increase the company profitability by investing the collected insurance reserves within the group.

In turn, a diversified portfolio contains a combination of different types of assets and investment instruments in an attempt to limit the exposure of any single asset or risk. The rationale for this method is that the portfolio consisting of different types of assets will, on average, yield higher long-term returns and reduce the risk of any single holding company or security.

Diversification is aimed at smoothing out unsystematic risk events in the portfolio, so the positive results of some investments neutralize the negative results of others. The diversification benefits persist only if the securities in the portfolio are fully correlated, i.e. they respond differently, often in opposite ways, to market influences [12].

It should be noted that investors can reap additional benefits from diversification by investing in foreign securities, as they are generally less closely linked to domestic securities. For example, forces that oppress the USA economy may not affect Japan's economy in the same way.

Thus, the Japanese shares ownership gives the investor a small cushion of protection against losses during the economic downturn in the USA.

Depending on the specific areas and activities, the enterprise may use diversification to reduce the following types of risk:

- production risk (diversification of activities and product range);
- deposit risk (the deposit portfolio diversification by placing free cash balances in not one but in several banks);
- credit risk (the loan portfolio diversification by providing deferred payment to a large number of products buyers with simultaneous limitation of the credit amount per customer);
- currency risk (the currency portfolio diversification by forming a "currency basket" in order to avoid the risk of choosing a currency);
- liquidity risk (the securities portfolio diversification by types of financial instruments, investment terms, industries and regions of emitters activities, etc.);
- reduced risk of profitability (the investment projects portfolio diversification by terms, regions, industries, etc.).

Reduced risk, instability buffer: diversification has many advantages, but there are also disadvantages. The more holdings a portfolio has, the more time it may take to manage and the more expensive it is, because buying and selling many different holdings entails higher transaction fees and brokerage fees. More fundamentally, the strategy of expanding diversification works in both directions, reducing both risk and profit [12, 13]. That is, by protecting against losses, diversification limits opportunities for growth – at least in the short term prospects. In the long-term prospects, diversified portfolios tend to yield higher returns. The ultimate goal of diversification is to reduce portfolio volatility by compensating for losses in one asset class and profit in another asset class.

Conclusions

Financial risk has a dynamic nature, which changes its quantitative level under the influence of both external and internal factors, regardless of the enterprise operation stage. Its level can and should be influenced.

The purpose of each enterprise is to obtain maximum income with minimum capital costs in a competitive environment. The implementation of this goal requires a comparison of the amount of capital invested in production and trade activities with the financial results of this activity.

At the same time, when carrying out any type of economic activity, there is objectively a danger (risk) of losses, the amount of which is determined by the specifics of a particular business. Risk is the probability of losses, wastes, shortfalls of planned

income, profit. Losses that occur in business can be divided into material, labour, financial. For a financial manager, risk is the probability of an adverse outcome.

Minimizing financial risks is a set of measures to prevent the funds loss. In any kind of economic activity there is a probability of losses arising from the peculiarities of the operations. Perceived risks need to be calculated and reduced to minimum amounts. For this purpose, risk management is the analysis system of cash losses and management of financial relationships that arise in a business is used. In this type of management, the most important are internal and external mechanisms of financial risks neutralization (minimization). Nowadays, in the practice of domestic enterprises, various options are used to reduce financial risks, but it is worth paying attention to foreign experience in order to optimize the Ukrainian risk management. One of such options is insurance. Insurance involves transferring the risk to the insurance company. The demand for financial risk insurance is growing in Ukraine, however, due to insufficient financial literacy of entrepreneurs and insurance culture, the demand for this type of insurance is growing very slowly. Another appropriate option is the diversification method, which reduces the risk by allocating investments across different financial instruments, industries and other categories. It is aimed to maximize returns by investing in different industries, each of which responds differently to the same crisis.

Abstract

The article examines in detail all the most important aspects of the enterprise financial risk and its minimization. It is noted that in the literature there is no single approach to this concept definition. However, almost all the enterprises face the need to minimize financial risks, the main ways to minimize them are identified by the authors. A new classification of financial risks according to the current economic problem associated with the pandemic is proposed. Insurance and diversification are considered in more detail as one of the most popular and promising ways to minimize risks abroad.

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Посилання на статтю:

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