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INTERNAL SOURCES OF BUSINESS FINANCING

Forms of internal financing of business capital are considered in the article, as well as ways of open and hidden self-financing. Analysis concerning the opportunities of internal financing of home business is carried. Advantages and disadvantages of internal sources of financing are determined.

Introduction

Lack of financial resources in numerous subjects of economy takes place in conditions of establishment and development of market relations in Ukraine. It is stipulated by numerous circumstances. In the first instance, by high cost of entangling of financial resources, as a result of undeveloped bank system and funds market. Secondly, by imperfection of taxing system, which is directed on immobilization of financial resources of business subjects. Thirdly, by insignificant volumes of foreign investitions, as a result of ukrainian business opacity.

The undeveloped system of financing causes appearance and growing of such unexpected sources as debts before economy subjects, in job payment and taxes payment. These tendencies influence productive activity in negative way, diminish the opportunities of financing of further enterprises development, diminish budget receipt. In such conditions all the measures, connected with mobilization of financial resources, their usage, increase and reversion play an important role in realization of financial and economic activity.

Literature Review

Great contribution into the creation of theoretical and methodological basis for determination of nature of financial resources and processes of their formation and usage was made by home scientists-economists: Bilyk M. D., Blank I. O., Buriak L. D., Vasylyk O. D., Danylenko A. I., Zagorodniy A. G., Ziatkovskyy I. V., Kostyrko L. A., Senchagov V. K., Ogorodnyk S. Y., Oparin V. M., Pavliuk K. V., Podderiogin A. M., Romanenko O. P., Tereshenko O. O. and others. In Russia financial resources were studied by Bielolipetskiy V. G., Vahrin P. I., Kovaliov V. V., Kolchina N. V., Moliakov D. S., Pavlova L. P., Poliak G. B., Pomanovskiy M. V., Savchuk V. P., Skamay L. P., Tkalich G. I. and others. But there are still a lot of important questions concerning optimum financing of home enterprises, they include the search of ways to decrease expenses on entangling of financial resources and achievement of maximum financial results.

The goal of the article is the research of internal sources of business financing, search of optimum ways of financing.

Sources of internal finance

Internal financing is the phrase used to describe funds that firms obtain without using external resources, mobilized on the capital market [1].

In other words, it's the part of financial resources, generated from operating and investment activities rather than attracting funds on capital market.

Speaking of the internal financing, it should be said that the capital, invested in negotiable and non-negotiable assets (except for cash resources and their equivalents), is issued and transformed in liquid assets in the form of sales proceeds and other incomings remained after taxes.

The major internal sources of finance are: money gained from reevaluation of fixed assets, capital allowances, retained profits, capital reserves, future payments reserves.

Capital allowances are very important for capital accumulation. The experience of market economy countries shows that during a crisis, the capital allowances should equal 70-75 % of total development financing, while in a favorable period - 50-60 %.

Capital allowances in Ukraine amounts to about 10-12 %, which bounds the renewal of production facilities, which can only maintain the current level of production.

The new system of national standards of accounting does not bind the amount of a fixed capital (as well as another component of the ownership capital, except for additional capital in case of the reevaluation of main funds) of a company with capital allowances charges. Depreciation fund, as a separate element of an ownership capital, is not set up. Depreciation charges, after the production is sold, arrive as proceeds and flows into the total gain of a company.

As the amortization of negotiable assets is of target appropriation which is the recovery financing of these assets, the financial department should constantly control the purpose use of these funds, i.e. the financing of capital investments. It's achieved via the means of management accounts.

Types of self-financing

Depending on the representation of a profit in a summary report, particularly in the balance sheet, the self-financing can be hidden and open.

The major internal source of the open self-financing is reinvestment of profit. In this connection, 75 % of the annual operating profit is spent for the payment of interest, taxes, and dividends, while only 25 % remains in a turnover.

The effect of the open self-financing shows itself from the moment of net profit earning to the moment of its distribution and payment of dividend. The decision of owners about the amount of self-financing is at the same time the decision on the amount of dividends to be paid.

The main advantages of the open self-financing include: there's no need to pay back the attracted funds and pay a fee for using them (though its cost is a tax); absence of fund raising costs; loan guarantee is not required; greater levels of financial independence and solvency are provided.

Disadvantages of the open self-financing are: net profit is liable to taxes in advance, which means that the value of this financing source increases; limited possibility to control the internal financing reduces the requirements to the efficient application of funds; wrong investments (ownership capital is invested in risky projects).

Hidden self-financing is a use of hidden dividends via the creation of hidden resources, which can only be seen at liquidation.

Hidden self-financing is made at the expense of a pretax profit, in other words the payments of taxes and dividends are postponed.

There are two main ways of forming hidden reserves in a balance: undervaluation of assets - early amortization of special assets, application of accelerated amortization, disuse of indexing, using of LIFO method for the evaluation of resources etc; revaluation of liabilities, for instance in such items as «Securing of the following charges and payments», «Current obligations on internal accounts» etc.

According to statistics, western companies evaluate their resources using the LIFO and FIFO methods, which is 60 % of all evaluations, the LIFO prevailing. The next is the method of an average value (30 %), other methods (10 %).

The effect of financing via securing of the following charges and payments becomes noticeable due to a time gap between the moment of their formation (charge) and application (of payments). The amount of guarantees, included in total costs, is limited by tax legislation.

Basic guarantees, given by a company, are: fulfillment of warranty obligations, securing of payments to employees (holiday pay reserve); supplementary provision of pensions etc. The remains of such funds in German big companies reach 15 % of a balance and often exceed the value of a capital stock. To make a comparison: a specific weight of all guarantees in capital structure of Ukrainian companies is 2 % (A company fulfills its warranty obligations (service) concerning the goods with a warranty period) [5].

Mobilization of hidden reserves is performed: by realization of certain objects of fixed and circulating assets; by indexing of a book value of property objects.

Cash flow

There are two main concepts of considering the essence and classification of internal sources of financing.

The first approach deals with the financial results, the second one - with the cash flow. The reason for this is that a company's profit and spending, represented in a report on financial results, do not necessarily coincide with receipts (outlay) in its operating and investment activity.

American analysts began to use the cash flow statement in the 50s of the 20th century for analyzing securities and investment activity.

The information about a company's cash flow during a defined period of time is found in the cash flow report. The cash flow report is a national equivalent of a cash flow statement, composed according to the international accounting standards (IAS).

The cash flow statement breaks the sources of cash generation into three sections: operational, investment and financing.

The basis for calculation of the general cash flow statement is the operating cash flow, which refers to the amount of cash a company generates from the revenues it brings in, excluding costs associated with operating activities.

Measurement of cash flow can be used to evaluate the state of internal potential of financing a company. The adequate rate of the operating cash flow makes favorable conditions for attracting funds from external sources. Operating cash flow shows the ability of a company: to finance investments by internal financial sources; to pay off debts; to pay dividends.

Economists are not unanimous in seeing the methods of calculating the cash flow [4].

The classical method: operating cash flow = net profit (after taxes) + depreciation + cover fund growth.

«Classical» (gross) cash flow - dividends = net cash flow. This approach does not take into account changes in composition of working assets and liabilities, which also have a profound effect on the size of a company's cash resources.

There are two generally-accepted methods of calculating cash flow from operating activities: the direct method and the indirect method. These methods take into account the mentioned changes in the structure of working assets and liabilities and charge payment of interest to transaction costs.

According to the direct method, net cash flow is a difference between money received and money spent.

The money received: proceeds from the sales made; offset of accounts receivable; other incoming amounts (e. g. sale of circulating assets, lease of assets etc).

The money spent: expenses included in production price; administration costs; shipping costs; cash paid for other operating expenses; taxes; cash paid for interest expense.

There's a controversial question on whether the operating cash flow should include the cash paid for interest expense [6]. Logically, payment of interest should belong to the cash expenses from financial activity. According to international standards of financial accounting, this position belongs to the operating cash flow.

The direct method analyzes the influence of cash flow on current and potential liquidity of a company. Carrying out an internal analysis, one cannot determine a cash flow by the direct method because of the null information on cash paid for raw materials, goods etc.

That's why to measure solvency or investment appeal of a company, the indirect method, based on official accounting information, is used.

The financial result from operating activity before taxes is a basic value of the indirect method. The calculation is opposite to the direct method, i.e. the operating gain (loss) is corrected via: the income item (decreases) and the expense item (increases), which do not affect the amount of cash resources (depreciation, securing of further expenses and payments); the amount of nonmonetary items in circulating assets (e.g. accounts receivable, inventory) and the amount of current liabilities (e.g. bills payable); the items showing gains and losses from investing and financing activities.

The main rules are: the profit from general activity before taxes should decrease by the amount of increase in nonmonetary circulating assets and increase by the amount of decrease in them; the profit from general activity before taxes should increase by the amount of increase in any item of short-term liabilities and decrease by the amount of decrease in them.

Measurement of cash flow can be used to evaluate the quality of business management.

The business management is considered successful if net cash flow in the result of: the operating activity has positive value, the investing activity - negative, and the financing - negative.

It means that in the result of operating activity namely from sales of products, a company receives enough cash to make investments and pay loans. At that, to make investments, the company has enough internal funds. And if in this case the net cash flow resulting from the firm's operations also has positive value, it can be said that the management did its job well.

The business management is considered satisfactory if net cash flow in the result of: the operating activity has positive value, the investing activity - negative, and the financing - positive.

The structure of such a cash flow: cash received as a result of operating activity, loans and investments (financial activity) a company uses for acquisition of fixed assets. Net cash flow received as a result of all kinds of activities during a defined period of time should also be positive.

The business management is crisis if net cash flow in the result of: the operating activity has negative value, the investing activity - positive, and the financing - positive.

In such a case, the company may be deriving operating cash by receiving investments and through financial activities. Such a structure is appropriate only for the newly established companies, which have not yet started working to their full capacity and are still at the stage of growing.

The quality of business management will only be on an acceptable level if a financial activity generates a positive cash flow.

Conclusions

So, there are general recommendations concerning optimum business financing, but there is no universal and ideal scheme of business financing. The determination of this optimum is the task of every enterprise and depends on assets structure, specificness of the activity, increasing or decreasing economy on scale and presence of new profitable projects. The criterion of optimum is low cost of capital, liquidity, financial stability and independence of an enterprise.

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Базілінська О. Я.

ВНУТРІШНІ ДЖЕРЕЛА ФІНАНСУВАННЯ ПІДПРИЄМСТВ

У статті розглядаються форми внутрішнього фінансування капіталу підприємств, шляхи відкритого та прихованого самофінансування. Аналізуються можливості внутрішнього фінансування діяльності вітчизняних підприємств. Визначаються переваги та недоліки внутрішніх джерел фінансування.