Company Financial Strategy’s Institutionalization: Theoretical Aspects

Under today’s conditions of exogenous and endogenous challenges for economic agents, the problem of ensuring value creation for stakeholders on a long-term horizon is becoming more acute. The lack of adequately formed institutions within Ukraine’s market infrastructure adds additional complexity to the task. The aim of this paper is to identify the features of an effective financial strategy institute in Ukraine. This paper examines issue of forming and further functioning of financial strategy institute at company, industry, and state level. The problems of Ukrainian corporate sector genesis in the context of the formation of market institutions are described. The effect of information asymmetry and principal-agent conflict on the process and results of value creation for stakeholders is highlighted. Ways to reduce the influence of the principal-agent conflict through institutionalization are proposed. Paper also considers financial strategy’s institutionalization as a factor influencing investors’ interest in the company. It is noted that the existing incentive tools for the company’s managers are aimed at the short-term horizon. It is emphasized that the financial strategy’s institutionalization would contribute to overcoming excessive fixation on the company’s short-term results, instead, an adequate balance would be formed regarding short- and long-term priorities at the company level. Financial strategy institute’s placement in the company’s management architecture is defined. The conducted research may be useful for researchers in the field of corporate governance and corporate finance, private and state-owned companies, industry associations, and state authorities. Prospects for future research are an in-depth analysis of the financial strategy institute’s infrastructure, in particular, in terms of its quantitative analysis and evaluation.

Keywords: institute; financial strategy; stakeholder; principal-agent conflict; corporate governance; short termism

Г. О. АЛЕКСІН
кандидат економічних наук,
доцент кафедри корпоративних фінансів і контролю
Київський національний економічний університет імені Вадима Гетьмана

Інституціоналізація фінансової стратегії компанії: теоретичні аспекти

У сучасних умовах екзогенних і ендогенних викликів для економічних агентів загострюється проблема забезпечення створення вартості для стейкхолдерів на довгостроковому горизонті. Додатковою складністю задачі додає брак адекватних сформованих інститутів в українській інфраструктурі ринку. Метою статті є виявлення особливостей побудови ієрархії інституту фінансової стратегії в Україні. В статті вивчено проблематику формування та подальшої роботи інституту фінансової стратегії на рівні компанії, галузі, держави. Описано проблематику генези корпоративного сектора України в контексті формування інститутів ринкового управління. Виділено вплив асиметрії інформації та конфлікту принципал-агент на процес і результати створення вартості. Запропоновано шляхи скорочення впливу конфлікту принципал-агент за рахунок розбудови інституту фінансової стратегії.

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Problem setting. Current volatile business environment causes a lack of strategic focus among key economic agents. Instead short-term solutions come forward as a response to market volatility, constrained resources, and lack of understanding the future in the light of growing uncertainty. At the same time, there is a growing expectation on behalf of strategic stakeholders (e.g., institutional and strategic investors, shareholder activists, local communities, etc.) for more aligned and forward-looking company management. Hence, there is an increasing interest in the adequate market management tools and structures that function autonomously over long time – in other words, institutions.


However, corporate financial strategy institutionalization is not studied sufficiently in the existing research.

Aim of the study is to outline role of institutionalization as a means of stimulating efficient financial strategy process of Ukrainian companies. Based on the set aim of this study the following objectives are formed, namely:

- Perform an overview of the underlying drivers for Ukraine’s corporate sector development peculiarities in light of institutionalization;
- Analyze role of the institutionalization as a means for stimulating effective and balanced long-term development for Ukraine’s corporate sector;
- Propose solutions of applying institutionalization toolkit for more efficient financial strategy process of Ukrainian companies.

Results. Ukraine’s economy ongoing crisis has an institutional nature, which transpires in formal creation of institutions and attributes of the market economy, which at the same time are inherently inefficient. For instance, Ukrainian companies’ corporatization process was of a formal nature [12, p. 30]. This point of view is supported by the dominance of internal sources of financing in Ukrainian corporate sector. That was caused, firstly, by the desire to avoid the loss of control over the company and, secondly, resulted from companies’ low transparency, which significantly limited access to other sources of financing. The above mentioned is also supported by heavy usage of bank loans (often within the corporate structure of financial and
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industrial groups) – to the detriment of other sources of borrowed capital (i.e., bond emission, etc.). There is also avoidance of such a modern form of financing as debt securitization [13, p. 64]. In turn, these outlined above peculiarities of market economy formation process in Ukraine are revealed in a sizeable shadow economy. In particular, Tereshchenko [14] indicates a «specific subculture of shadow business, which does not imply implementation of clear, fair and transparent corporate governance standards that are understandable to all game rules» [14, p. 383]. That indicates that Ukraine’s market economy formed over last three decades was not fully “market” by its nature with relics of centrally-controlled economy with additional layering of basic capital accumulation.

Furthermore, Ukrainian companies’ IPOs and SPOs were often of quite a specific nature, de facto being not open to participation on behalf of the general public and professional investors [15, p. 69], and held exclusively for the needs of a single controlling stakeholder. Moreover, there is de facto a limitation of minority interest rights in Ukrainian corporate sector, and a chronic non-payment of dividends. Hence, stakeholders controlling Ukrainian companies pursue other motives than those defined both by the theories of corporate finance, and best business practices (e.g., Value Based Management). In our opinion, the explanation for this behavior is an excessive focus on achieving short-term goals to the detriment of long-term priorities for objective, aggravated by absence of institutional structures which could support a balanced approach towards company management.

Among the factors that contribute to the spread of short-termism in developed countries are the rapid development of technologies, reduction of the time required to execute a transaction on the stock market, lowering costs of a financial transaction, higher market volatility, increase in media activity, rise of shareholder activism [16]. In particular, 78% of CFOs surveyed by US National Bureau of Economic Research are inclined to sacrifice future growth in value for the sake of achieving forecasted financial indicators in the short term [17, p. 37]. In Ukraine’s economy context, we assume that short-termism is caused by significant uncertainty regarding the medium and long-term horizons, which pushes stakeholders to seek short-term benefits.

Strengthening information asymmetry and the principal-agent conflict are key results of short-termism. It should be noted that in Ukrainian practice there is a lack of study of stakeholders’ interests in management decision-making process. As a result, there is also a lack of research on stakeholders’ rational and irrational reactions in response to company’s actions. The stakeholder in its own way interprets the company’s actions and forms opinion on its prospects. Hence, even with a company’s management decisions being right and managerial actions being aimed at value creation – yet incorrectly articulated and communicated – stakeholders could interpret the consequences of those actions in an erroneous way and react inadequately. In practice, that leads to formation of an unattractive investment policy on behalf of long-term strategic investors, lack of intentions on doing business on behalf of suppliers and customers, reluctance of high-skilled professionals to be employed with such a company, lack of support from the public authorities (i.e., subsidies, public procurement contracts), etc.

The solution lies in the study of motivations and opinions of stakeholders with further consideration of these aspects in the planning, implementation, and communication of company’s management decisions. In particular, the study [18] highlights the characteristics of the company’s activity that are noted by long-term investors as important in decision-making, namely:

- reputational risks due to questionable supply chain management practices (15% of respondents);
- a sharp reduction in the level of consumer satisfaction (14%);
- inadequate response to changes in company’s external environment (13%);
- a weak corporate leadership program (10%);
- significant changes in the company’s assets or capital structure (9%);
- a sharp reduction in the level of employee satisfaction; reductions in R&D program and usage of funds for shares buy-back (8%).

Accordingly, these aspects of the company’s activity are often outside the key focus area of the company’s top-management or divisions’ managers, who in turn are focused on other characteristics of company’s activity due to information asymmetry and the principal-agent conflict.
Researchers [16-18] emphasize that there is a sufficient toolkit for motivating company management to achieve short-term goals, however, such tools for motivating and controlling company management in terms of creating long-term value are extremely insufficient. This is confirmed by the McKinsey & Co. research [19], in particular: 79% of respondents feel pressure to demonstrate high financial results in the horizon of less than two years; 63% of respondents note the growing pressure to achieve short-term results; 46% of respondents feel pressure to focus on short-term financial results coming from the board of directors, which in turn tries to satisfy institutional investors’ demands to achieve short-term results in this way; 44% of respondents are building a strategy with a horizon of less than three years [19]. Those findings indicate that there is a need for re-focusing stakeholders on long-term horizon, which could be achieved through development of adequate institutions, in particular in strategy and finance aspects both on corporate and state level.

A potential solution to overcoming the consequences of short-termism is to institutionalize corporate financial strategy, i.e. evolve infrastructure of strategic management in terms of company’s market and financial position with a focus on expertise, business-process, organizational structure, communication, adequate checks and balances. That process could take form of establishing an independent expert body. Such an institution is built upon internal entrepreneurship and responsible management principles. We propose the following framework for the purpose mentioned above (Figure 1).

Figure 1. Framework for functionality of institutionalized financial strategy

Source: constructed by author.

Further we consider the outlined functionality in more detail:

- Coordinate goals, organizational divisions, operational and strategic plans for the company;
- Strategize development and implementation of long-term plans, adopting organizational structure to the requirements of strategy implementation, carrying out portfolio analysis, enabling VBM practices;
- Support operations through insights based on data and information enabling efficient decision-making process on different corporate levels (i.e., management accounting system, information flow automation, preparation of consolidated financial statements, lean analytical reports for different management levels, etc.) [20, p. 35-37];
- Consult through providing qualified management support regarding operational, financial, and investment activities; resolving potential conflicts of interest at all levels; development and coordination of the compensation system and motivation programs based on KPIs and employees’ individual goals [20, p. 35-37]
Check & balance decision making flows within the company with a focus on efficiency of decision making process, ensuring its reliability, minimizing conflicts of interest.

That requires an efficient and informed board of directors with a specific focus on its expertise (in particular in independent directors component) – being, an infrastructure of expert bodies that have control and advisory functions, but act at a strategic rather than an operational level. Global trends show that supervisory boards increasingly gravitate to the function of a bearer of expertise, devoting more and more time in their work to discussing precisely strategic issues [21]. The above-mentioned series of measures directly corresponds to board of director’s focus on the transition to the role of an expert body at company level. That occurs in the context of moving away from formal post-control of strategic plans’ implementation to the pro-active involvement in corporate strategic planning. In particular, in this context efficient board of directors and independent directors have to:

- cover all components of effective strategic planning with their expertise and establish their relationship with the process of strategy development and implementation at the enterprise;
- conduct an in-depth analysis of the industry and the market in order to identify areas of potential opportunities and threats;
- carry out an assessment of the company’s ability to conduct strategic changes and take into account the identified potential opportunities and threats;
- effectively support the process of strategy development and implementation;
- to communicate progress in strategic changes to managers, as well as external and internal stakeholders;
- act as an effective anti-crisis management institution and mediator body.

Hence, there is a need for building up an adequate infrastructure within a company for ensuring that strategic financial management and value creation process are functioning both in short-term and long-term. The above-mentioned infrastructure has to reflect the organizational structure, specific corporate goals, functionality, set of business processes on resource allocation and change management. All of that could be incorporated within a Financial Communication Framework [20, p. 182-185].

Figure 2. Blueprint for institutionalized financial strategy

Source: constructed by author.

Hence, the proposed framework for institutionalizing financial strategy has to encompass different institutions – first of all, on the micro-level. These institutions are represented by the following blocks: Stakeholder value, Board of Directors, Financial Communication, Stakeholder groups. In turn, these blocks are interconnected by signals. These institutions
are reconciled within the Financial Communication Framework, which accommodates and coordinates a set of goals, management decisions focused on achieving company goals, information flows and business processes which support the decision making process – which represents strategic process on the company level. Financial communication in turn enables through signals an efficient link and feedback between corporate strategic process and stakeholder groups, thus, ensuring a long-term value creation through institutionalization of strategic finance process. Furthermore, such a comprehensive structure enables proliferation of financial strategy’s institutionalization not only on company-level (i.e. micro-level), yet also at industry-level and state-level (i.e., stock market). That could reveal itself in further adoption of best practices in strategic financial management and corporate governance, and outlining key directions for corporate sector development in Ukraine.

Conclusions. Summing up, we conducted a research on issues of specific characteristics of financial strategy institute and peculiarities of its development in Ukraine. This problem is considered both in the context of market economy development (endemic to Ukraine) and excessive short-term fixation (which is a world-wide characteristic).

Analysis of exogenic and endogenic environment provided basis for outlining institutionalization’s role as a means of stimulating efficient financial strategy process for Ukrainian companies. That analysis is based on an overview of the underlying drivers of Ukraine’s corporate sector development. Lack of adequate institutions is identified as the key issue. Hence, institutionalization’s role is emphasized as a means for stimulating effective and balanced long-term development of Ukraine’s corporate sector. In particular, institutionalization through support of check-and-balances system enables higher transparency, decrease in short-termism, and overcoming of principal-agent conflict. As a way for implementing these changes a framework for functionality of institutionalized financial strategy is proposed. These framework encompasses key tasks of corporate financial strategy, providing a balanced view of responsibility zones and available influence levers. As a further solution for implementation a blueprint for institutionalized financial strategy is developed. That serves a solutions of applying institutionalization toolkit for more efficient financial strategy process of Ukrainian companies. Prospects for future research lay in deeper analysis of infrastructure supporting financial strategy institute in its functional and structural blocks with a special focus on corporate governance as a tool for enhancing long-term and short-term results both in strategy and finance respects. Further research would also focus on quantitative analysis and evaluation of financial strategy institute.

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