



KAPITEL 1 / CHAPTER 1¹
ELEMENTS OF THE ENTERPRISE FINANCIAL RISK MANAGEMENT
POLICY

*ЭЛЕМЕНТЫ ПОЛИТИКИ УПРАВЛЕНИЯ ФИНАНСОВЫМИ РИСКАМИ
ПРЕДПРИЯТИЯ*

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Introduction.

Achieving efficiency is the goal of the creation and operation of every business entity. Instead, external and internal environmental factors negatively affect the financial performance of enterprises, resulting in a variety of risks that are likely to lead to financial losses.

The problem of enterprise risk management has become particularly acute in recent years, as Ukraine is in a state of economic, political and social crisis. According to the State Statistical Service of Ukraine, although the number of enterprises continues to grow, the share of unprofitable enterprises is almost unchanged every year – 26-27% [1]. A survey of manufacturing companies found 38% threatened with bankruptcy, 33% overdue, and 100% out of control over the external financial environment. That is why the issue of financial risk management is relevant today, and with the emergence of new challenges in the external environment will become increasingly important.

1.1. The essence of financial risks and the reasons for their occurrence.

The variability of the environment necessitates constant monitoring of risks and urgent measures to neutralize them. This, above all, requires a clear understanding of the types of financial risks and the factors that cause them.

In a broad sense, risk is the probable risk of loss by an entity of part of its own resources, loss of revenue or incurrance of additional costs compared to the forecast due to accidental changes in economic conditions, adverse circumstances. The most significant role in the overall portfolio of enterprise risks is a special group - financial risks. They arise directly in the sphere of financial circulation and are the probability of occurrence of negative financial consequences, which are expressed by loss of profit

¹*Authors: Olena Lytovchenko, Olena Toporkova*



or capital under certain uncertain conditions of financial activity [2].

Risk needs to be managed, various measures need to be taken, which allow to some extent to plan the implementation of risk events and to take measures to reduce the degree of risk. The effectiveness of risk management is determined by its classification [3]. This classification, which is scientifically sound, contributes to a detailed study of the place and nature of each risk in their entirety. It creates the preconditions for the effective use of appropriate risk management techniques and methods, as each risk corresponds to a separate system of risk management techniques. Thus, according to the classification, financial risks can be divided into groups: according to the level of financial losses: tolerable risk, critical risk, catastrophic risk; by area of origin: external risk, internal risk; predictability: forecasted risk, unforeseen risk; by duration of exposure: permanent risk, temporary risk; by possible consequences: risk of financial loss; risk of lost profits; risk of loss or additional income; by object of origin: the risk of a separate financial transaction, the risk of financial activities, the risk of financial activities of the enterprise as a whole; if possible further classification: simple risk, complex risk and others. In the process of finding a rational solution to applied, practical problems of financial management, the choice of risk classification should be performed according to a certain system, which should correspond to the type of financial management model and be chosen by the analyst as a basic, unique for all business planning.

Regarding the establishment of the causes of financial risks, they are quite diverse and have external and internal origins. Factors influencing the level of financial risks are divided into objective (external factors) and subjective (internal factors). Objective factors include: the level of economic development of the country; the nature of state regulation of financial activities of the enterprise; inflation rates in the country; the situation of supply and demand in the financial market; the level of competition in certain segments of the financial market; the level of criminogenic situation in the country (region); factors of force majeure group. Subjective factors include: the main parameters of the financial strategy of the enterprise; financial mentality of owners and managers in the policy of acceptable risks; the amount of equity of the enterprise; structure of used capital; composition of assets used; the nature of the financial instruments used in carrying out certain financial transactions; sufficiency of the used information base of financial management; characteristics of financial transaction partners; level of qualification of financial managers [4].

As the company cannot influence external risks, special attention should be paid



to internal risk management mechanisms.

1.2. Fundamental issues of financial risk management policy formation

The purpose of the risk management policy is to organize a clear process for effective risk management by setting limits for each type of risk, through systematic monitoring, control, reporting and mitigation of all types of risks at all organizational levels of the enterprise. This is reflected in the policy of financial risk management.

Financial risk management policy is part of the overall financial strategy of the company and is to develop a system of measures to identify financial risks, assess the level of their concentration and probability of occurrence, prevention of undesirable consequences of risk events and compensation for losses. This policy is reflected in the strategy and tactics of identifying and neutralizing financial risks. The analysis of the scientific literature testifies to the existence of different points of view on the process of development and implementation of financial risk management policy at the enterprise. That is why it is advisable to systematize the existing approaches to the formation of financial risk management policy and the formation of an algorithm for its implementation, which aims to ensure the most effective financial risk management in the enterprise.

The study of scientific approaches [2, 3, 4, 5, 6, 7] on the formation of financial risk management policy has allowed to form their basic principles.

Principle 1. Awareness of risk-taking. The financial manager must consciously take risks if he expects to receive the appropriate income from the financial transaction. Of course, after assessing the level of risk of individual transactions, you can apply the tactic of "risk avoidance", but it is impossible to completely eliminate risk from the financial activities of the enterprise, because financial risk is an objective phenomenon inherent in most business transactions.

Principle 2. Risk management. The portfolio of financial risks should include mainly those that can be neutralized in the management process, regardless of their subjective or objective nature. Risks that cannot be managed (for example, risks of force majeure) can only be transferred to the insurer.

Principle 3. Independence of individual risk management. The risks are independent of each other. Financial losses on one of the portfolio risks do not necessarily increase the probability of occurrence of a risk case on other financial



risks, ie financial losses on different types of risks are independent of each other and in the process of managing them they must be neutralized individually.

Principle 4. Comparability of the level of accepted risks with the level of profitability of financial transactions. The company should take in the process of financial activities only those types of financial risks, the level of which does not exceed the appropriate level of profitability under the scheme "profitability - risk".

Principle 5. Comparability of the level of accepted risks with the financial capabilities of the enterprise. The possible amount of financial losses of the enterprise in the process of carrying out a risky operation must correspond to the share of capital that is reserved to cover it. Otherwise, the occurrence of a risk event will lead to the loss of a certain part of the assets that provide investment or operating activities of the enterprise, ie reduce its potential for profit and the pace of further development.

Principle 6. Cost-effectiveness of risk management. The costs of the enterprise to neutralize the relevant financial risk should not exceed the amount of possible financial losses on it, even with the maximum probability of a risk event.

Principle 7. Taking into account the time factor in risk management. The longer the period of financial transactions, the wider the range of associated financial risks, the less opportunity to ensure the neutralization of their negative financial consequences by the criterion of cost-effective risk management.

Principle 8. Taking into account the company's strategy in the risk management process. The financial risk management system should be based on general principles, criteria and approaches that correspond to the chosen development strategy of the enterprise.

Principle 9. Consideration of the possibility of risk transfer.

Taking into account these principles, the company forms an appropriate financial risk management policy, which allows not only to reduce the likelihood and amount of possible and actual losses due to risky events, but also to create conditions for the best financial results.

1.3. Components of financial risk management policy.

The process of managing the financial risks of the enterprise is a sequence of procedures that includes several main stages (Figure 1).

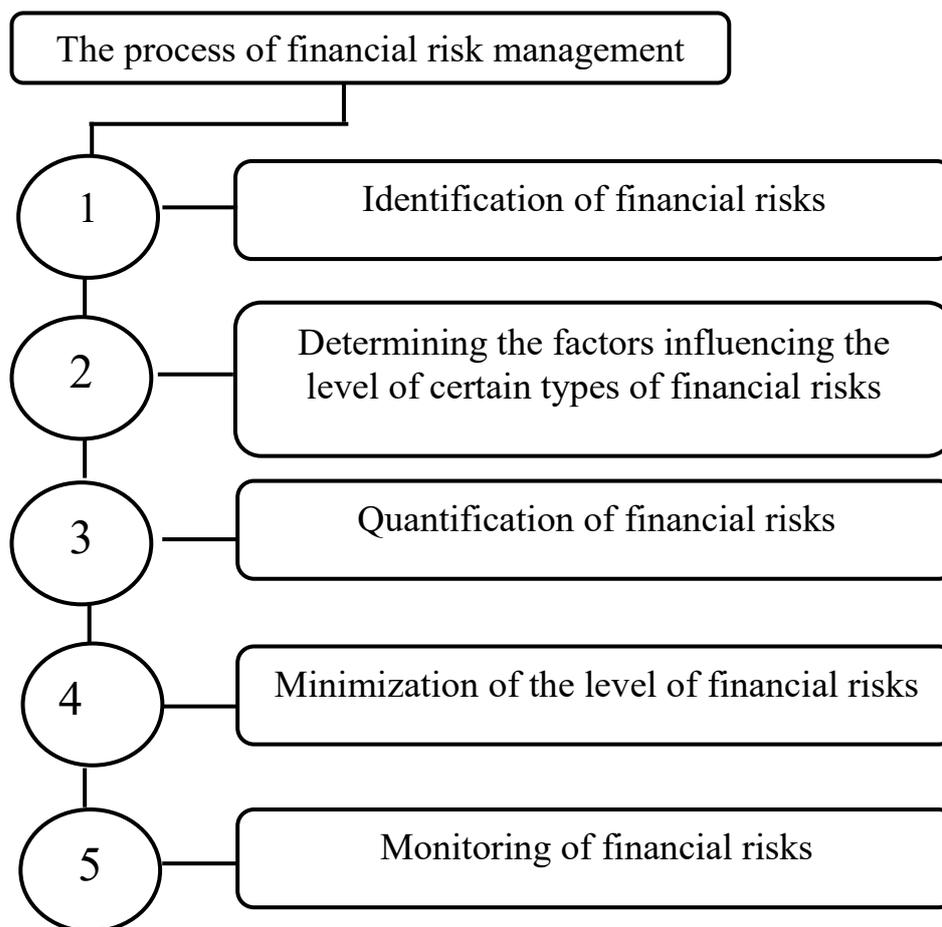


Figure 1. Stages of the process of managing financial risks of the enterprise

Stage 1. Identification of financial risks is a procedure that consists in establishing a list of certain types of risks associated with financial activities that are specific to this enterprise. For greater efficiency of the risk identification process, it should be carried out regularly during the implementation of the management decision. Risk identification should involve as many participants as possible: project managers, customers, users, independent experts, etc. The process of identifying financial risks takes place in three successive stages: identification of possible internal financial risks; identification of possible external financial risks; formation of a general portfolio of existing financial risks. For each area of financial activity (certain types of financial transactions), first, the inherent external (systematic) types of financial risks are determined. Secondly, the list of internal (non-systematic) financial risks that are inherent in certain types of financial activities or foreseen before the implementation of financial operations of the enterprise (risk of financial stability, insolvency risk, structural risk, credit risk, innovation risk and others). Third, a general portfolio of financial risks associated with the future financial activities of the enterprise is formed. The complexity of the practical implementation of the first stage of the risk



management policy development process depends primarily on the source and characteristics of the risk.

Stage 2. Determining the factors influencing the level of certain types of financial risks identified at the enterprise during the identification. The purpose of this stage is to establish the level of manageability of certain types of financial risks, as well as to identify ways to neutralize their negative effects.

Stage 3. Quantification is the measurement, analysis and assessment of financial risk. The quantification process is as follows:

First, the completeness and reliability of the information needed to determine the level of financial risk are assessed. Inaccurate or low-quality information base used in the process of assessing the level of financial risk increases the subjectivity of such assessment, and thus reduces the effectiveness of the entire subsequent process of financial risk management. Secondly, the level of probability of occurrence of certain types of risk is assessed. The choice of specific methods for such assessment is determined by the following factors: type of financial risk; completeness and reliability of the information base formed to assess the level of probability of various financial risks; the level of qualification of financial managers performing the assessment; technical and software of financial managers; the possibility of using modern computer technology to conduct such an assessment; the possibility of involving qualified experts in the assessment of complex financial risks, etc. To assess the probability of occurrence of certain risks, it is advisable to use methods: economic and statistical; calculation and analytical; analog; expert. Economic and statistical - based on mathematical probability theory; allow to get the clearest quantitative idea of the degree of probability of risk, but these methods can be used provided that there is sufficient statistical information. Calculation and analytical - allow to obtain a relatively clear quantitative idea of the degree of probability of risk based on the use of internal information base of the enterprise (for example, the value of planned indicators of economic and financial activities); These methods can be used to assess economic risk, insolvency risk and the risk of losing financial stability. Analog - determine the degree of probability of risk for some of the most popular operations of the enterprise; the use of these methods can be associated with assessing the probability of commercial, economic, price risk. Expert methods - are used only if the company does not have the necessary information or statistics to make further calculations; these methods are based on a survey of qualified specialists (insurance, tax, finance) with subsequent mathematical processing of the



results of this survey; expert methods can be used to determine the degree of probability of price, inflation, interest, tax, investment and other risks.

Third, determine the amount of possible financial costs in the event of a risk event for certain types of financial risks. The amount of possible financial losses is determined by the nature of transactions, the amount of assets or capital involved in transactions, the level of probability of relevant risks: transactions in which there is no risk, and therefore possible financial losses on such transactions are not forecast ; operations with the allowable level of financial losses; operations with a critical level of financial losses; operations with a catastrophic level of financial losses. Based on determining the level of possible financial losses for individual transactions, it is necessary to group them according to the respective risk areas. This grouping allows: to determine which operations are beyond the allowable risk (especially in the area of catastrophic risk), therefore, it is necessary to consider the feasibility of their conduct; assess the level of risk concentration for individual operations by determining the proportion of each operation in the relevant risk area; identify operations with a high level of risk concentration in all areas. Fourth, identify the length of the period of exposure to financial risks and the allowable value of the level of financial risk for individual transactions. This stage is carried out depending on the type of chosen financial policy at the enterprise (conservative, moderate or aggressive) in the context of a single operation. Fifth, an assessment of the level of financial, which logically justifies their prevention and management in order to minimize financial losses in the event of their occurrence. Sixth, perform a comparative analysis of the real and acceptable level of financial risks in the enterprise. As no business entity is able to avoid all risks, justified or acceptable risk is considered a necessary component of management strategy and tactics. Thus, the decision-making mechanism should not only identify the risk, but also allow to assess what risks and to what extent the entity can assume, as well as determine whether the expected return justifies the risk.

Stage 4. Minimization - is to reduce, limit or neutralize financial risks through appropriate management techniques. This process is carried out by successive actions: the choice of methods of financial risk management; development of measures to neutralize financial risks, implementation of measures to minimize them.

The vast majority of financial risks of the enterprise are covered by internal mechanisms of neutralization. The advantage of using internal mechanisms to neutralize financial risks is a high degree of alternative management decisions, which are usually independent of other entities. They are based on the specific conditions of



the financial activities of the enterprise and its financial capabilities, allow to take into account the impact of internal factors on the level of financial risks in the process of neutralizing their negative effects. The system of internal mechanisms for neutralizing financial risks includes: 1) Risk avoidance - the most radical direction of neutralization of financial risks, which is to develop such measures of an internal nature that completely exclude a particular type of financial risk (refusal to carry out financial transactions, the level of risk is excessive; refusal to overuse current assets in illiquid forms, refusal to use temporarily free monetary assets in short-term financial investments; 2) Limitation of risk concentration. The mechanism for limiting the concentration of financial risks is usually used for those types of operations that exceed the permissible level, ie for financial operations carried out in the area of critical or catastrophic risk. Such limitation is implemented by establishing appropriate internal financial standards in the company in the process of developing policies for various aspects of financial activities. Limiting the concentration of financial risks is one of the most common internal mechanisms of risk management, which implements the financial ideology of the enterprise without requiring high costs; 3) Hedging. In a broad interpretation, hedging characterizes the process of using any mechanism to reduce the risk of probable financial losses - both internal and external. In the narrow applied sense, hedging characterizes the internal mechanism of neutralization of financial risks based on the use of appropriate types of financial instruments (usually derivative securities - derivatives); 4) Diversification - this mechanism is used primarily to neutralize the negative financial consequences of non-systematic (specific) types of risks. At the same time, it allows to minimize to some extent certain types of systematic (specific) risks - currency, interest and some others. The principle of operation of the diversification mechanism is based on the distribution of risks, which prevents their concentration; 5) Risk allocation. The mechanism of this direction of neutralization of financial risks is based on their partial transfer (transfer) to partners on separate financial operations. At the same time, the part of the financial risks of the enterprise is transferred, according to which they have more opportunities to neutralize the negative consequences and have more effective methods of internal insurance protection; 6) Self-insurance (internal insurance). The mechanism of this direction of neutralization of financial risks is based on the reserve of the company's financial resources, which allows to overcome the negative financial consequences of those financial transactions that are not related to the actions of counterparties; 7) Insurance of financial risks - is the protection of



property interests of the enterprise in the event of an insured event (insured event) by insurance companies (insurers) at the expense of monetary funds formed by them by receiving from policyholders insurance premiums (insurance premiums). In the process of insurance the company provides insurance coverage for all major types of its financial risks - both systematic and unsystematic, while the amount of compensation for the negative effects of financial risks is determined by the real value of the insured, the sum insured and the amount of insurance premium.

Stage 5. Monitoring is to ensure constant control over the level of financial risk of the enterprise. The financial risk monitoring system of the enterprise should include two subsystems: monitoring of external risks and monitoring of internal risks. Monitoring of financial risks completes the cycle of their management and at the same time begins a new stage in identifying new possible threats to the enterprise.

The financial risk management policy developed at the enterprise envisages registration in the form of a special document - "business plan of risk management", which allows to present in a concentrated form the principles and mechanisms of financial risk management policy. It reflects the financial ideology of the company in relation to risk-taking, which is reflected in the financial strategy and financial policy on the main aspects of its activities; main types of risks inherent in the financial activities of the enterprise (portfolio of financial risks of the enterprise, compiled based on the results of their identification in terms of types of financial activities and major financial transactions); grouping the types of financial risks according to the degree of probability of their occurrence and the possible amount of financial losses in the event of a risk event; recommended forms of risk neutralization of certain areas of financial activities and major financial transactions; draft budget for neutralization of financial risks with calculation of cost-effectiveness; draft measures (indicating the date of their implementation and responsible persons) to ensure the neutralization of financial risks and their monitoring. The implementation of appropriate policies allows more efficient use of resources and allocation of responsibilities, improve the results of the enterprise and ensure its protection against risks.



Conclusions.

Financial risk management policy should be considered as part of the overall financial strategy of the company, which consists in developing a comprehensive system of measures to identify financial risks, assess their concentration and probability of occurrence, prevent undesirable consequences of risk events and compensate for losses. The absence of a financial risk management policy in the company can lead to significant losses or even bankruptcy and subsequent liquidation of the entity. Instead, taking into account, forecasting and analyzing financial risks in the activities of enterprises in accordance with the policy of financial risk management can prevent, avoid or minimize the consequences of adverse events.