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DOI: 10.23734/23.18.017

Priorities of financial strategy at the different stages of the life cycle of the enterprise

Abstract

The importance of a strategic approach in the management of the enterprise, ensuring its functioning and development is substantiated. The priority problems and tasks of financial activity of the enterprise at different stages of the life cycle are determined. The usage of modern financing methods depending on the stages of the enterprise life cycle is proposed.

Keywords

financial strategy, sources of financing, life cycle of the enterprise, indicators of financial strategy effectiveness

Introduction

The cycles of economic development, the processes of globalization of commodity and financial markets, and the intensification of competition increase the vulnerability of business entities to the impact of negative factors and require the development of a long-term plans taking into account the predicted dangers. At the same time, the complication of financial relations, the emergence of new financial instruments, the growth of the role of innovative solutions in development open up new opportunities which business entities must be ready to use with maximum benefit to themselves.

It is the ability to predict and react promptly to changes in the environment, to create mechanisms for risk neutralization and implementation of opportunities, rather than the precise implementation of planned tasks, which forms the basis of a strategic approach to enterprise management.

In the domestic and foreign literature, the concept of forming the life cycle of the enterprise is disclosed sufficiently thoroughly, the stages of the life cycle are characterized from the point of view of business activity, managerial technologies, organizational changes, innovation activities, etc. However, the peculiarities of the formation and usage of financial resources at different stages of the life cycle are poorly researched.

The purpose of the article is to determine the impact of the life cycle stages of an enterprise on the financial aspects of its activities and to substantiate the feedback – taking into account the stages of the life cycle in the formation of its financial strategy. In this research the authors proceed from the fact that the life cycle and its stages are an objective factor in the functioning of the business entity, but subjective management decisions, in particular in the financial plane, the enterprise can influence the trajectory of the life cycle curve, continuing or shortening the duration of a certain stage.

The essence and the importance of formation of the financial strategy of the enterprise

With the transition to a post-industrial economy, the strategic approach in management becomes a guarantee of the normal functioning and development of business entities, and the presence of strategic thinking in the management of companies transform into the factor of their competitiveness in the long run. The complexity and instability of external conditions actualize the flexibility of enterprise strategy, its multi variateness, require highly qualified developers, the availability of a systematic approach to solving problems.

The growing importance of financial relations in conjunction with the concept of strategic management requires special attention to the development and implementation of the financial strategy of the enterprise. It is the financial strategy in the context of diversifying financial relations, the emergence of new hybrid forms of financing, strengthening the financial dominance in economic processes becomes the main functional strategy.

The existence of a long-term development strategy, specified in the financial parameters, is a prerequisite for attracting investment, especially on a large scale. After all, with the development of market relations, orientation towards goods, technology has changed the interest in the finance of the enterprise and its management. This means that not only the possibility of increasing production volumes, but the improvement of financial indicators is a key factor in making investment decisions. For potential investors, the existence of an understandable financial strategy of the enterprise is not only a risk factor, but also a tool for evaluating its financial potential. Thus, it can be argued that a financial strategy is a financial policy aimed at achieving a certain increase in the market value of a business with an adequate level of riskiness and liquidity. Although the financial strategy is subordinate to the corporate strategy of the enterprise, its role is decisive.

The value of a financial strategy for an enterprise is that it makes possible: to maintain a strategic vector of development according to changing environmental factors; to concentrate efforts and resources on the most promising and most advantageous directions for the enterprise; to track, analyze and forecast actual and objective external trends; to specify possible ways to minimize risks; to eliminate the disadvantages of general corporate management, to form an adequate organizational structure of management; to balance the financial, industrial and social interests of economic agents.

However, the main value of the financial strategy of the enterprise, in our opinion, is that it is a factor of subjectivity, a tool for securing interests of stakeholders.

The multidimensional nature of the financial function and the multitude of tasks associated with it, the content of the financial strategy require an integrated approach. The current strategy, according to Blank I (2008)[1], should contain the following components (dominant fields):

1. Strategy for the formation of financial resources (financing strategy).
2. Investment strategy of the enterprise.
3. Strategy of providing financial security of the enterprise.
4. The strategy of improving the quality of financial management of the enterprise.

The first two directions are crucial for increasing the value of the enterprise. It is the maximization of value, and not the maximization of profit; it is the strategic goal of financial management. A well-grounded financing strategy leads to a reduction in the value of capital by choosing the most effective sources of funding, and rational investment contributes to the growth of business profitability in the future.

The financial strategy integrates a list of the main characteristics, the specific manifestation of which varies in individual enterprises in a rather large range, depending on the scale and characteristics of the activity, the internal financial structure, and the volume of financial potential, external environment, and others.

The scope of the economy in which the enterprise operates determines the amount of capital required for operating activities, the nature of resources, the duration of the financial cycle, and thus outlines the direction of its financial strategy. The financial strategy is developed by enterprises of the real sector as well as for financial enterprises. It is relevant for large enterprises, including TNCs, and for small enterprises. For each individual enterprise, the financial strategy is a unique model of its financial behavior, reflects the priorities of managers in the field of sources and forms of financing, investment, management of financial risks.

In Ukraine we can notice the growth of attention to the development of financial strategy in the banking and insurance business. The contemporary paradigm of bank

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[1] I. Blank, *Financial Management*, Elga, Kyiv 2008.

management involves the need to reorient the activities of banks from short-term results (in terms of profit, profitability of sales, market share served) to achieve long-term goals (the growth of capitalization and increase market value by providing customers with greater value in the forming of new banking products and services).

The financial strategy of an insurance enterprise is conditionally divided into three main components: strategy of management of insurance reserves, strategy of management of own capital, strategy of risk management. Financial strategies of leading insurance groups cover a wide range of activities (insurance, asset management, banking) and are aimed primarily at capturing profitable strategic financial positions. In strategic financial management, leading insurance companies take into account fluctuations in exchange rates, use offshore companies, and introduce information openness.

Also, the scale of business affects the content and detail of strategic financial decisions. It is a mistake to think that a strategy is needed only for large companies with significant capital, while small business plans for the short term, is too sensitive and vulnerable to environmental changes in order to shape long-term strategies. However, the analysis of special literature and business practices suggests that small businesses that seek to secure their long-term competitiveness and development must have a financial strategy.

Important is the fact that in the process of implementing a strategy, the enterprise focuses not on one-time benefits, but on long-term goals. In essence, the goals are the benchmarks for enterprise development, and the strategy is a plan for their achievement. If in a particular period, before the leaders of the enterprise there is a dilemma, for example, about the directions of investment of funds, allocation of resources, expediency of realization of a certain project or conclusion of an agreement (especially if it requires additional attraction of debt capital), it is the availability of a strategic approach able to send on the right path. The decision should be implemented if it contributes (does not hurt) to achieve strategic goals. Thus, the strategy involves clear compromises and a conscious refusal to produce certain products or conclude agreements, focusing primarily on corporate interests, and not on the priority of the interests of structural or functional units.

To formulate a financial strategy, it is necessary to take into account a wide range of external factors, among them:

- general economic objective trends (they determine the prospects or hopelessness of a certain type of activity, investments and promote understanding of trends in the country or industry);
- legislative regulation of entrepreneurial activity and theirs predicted changes;

- economic and political situation in the country (contributes to the assessment of possible changes in the exchange rate, inflation, predicts the likelihood of a financial crisis, the independence of the judiciary, and the scale of the shadow economy);
- financial position and competitive advantages of existing and potential competitors, reliability of suppliers and solvency of buyers;
- the state of commodity and financial markets and theirs changes.

Influence of the life cycle of the enterprise on choice of financial strategy

Formation of financial strategy as a component of the overall strategy of the business entity, filling it with specific content, time frame, mechanisms of implementation depends on many factors, in particular on the stages of the life cycle of the enterprise.

Each enterprise develops cyclically and with corresponding changes. Development can be interpreted as „irreversible process aimed at changing the material and spiritual objects in order to improve them”. The life cycle of the enterprise is a set of specific goals and objectives of the enterprise, defined organizational and managerial decisions, the implementation and of which ensures its growth.

After analyzing the works of economists, two main theories of the enterprise's life cycle, which are widely covered in the scientific literature, can be distinguished. For example, Larry Grainer[2] in 1972 has developed an evolutionary concept of enterprise development. He sad, that overcoming the crisis, specific for this stage, carries out transition from one phase to another. The model of organizational development by L. Greiner shows that the need for changes in enterprises sooner or later arises irrespective of the ideology of development they follow, and management paradigm, which dominate in their functioning. However, how these changes in the enterprise will be carried out depends not only on the duration but also on the effectiveness of it's functioning.

The second most widespread concept of the enterprise's lifecycle belongs to I. Adizes (1998)[3]. The basis of separation of the phases of the cycle is the correlation of two parameters: flexibility (the ability of the enterprise to adapt quickly to internal and external changes) and controllability (the degree of regulation of the enterprise and its members, as well as the rigidity of coordination and control mechanisms). According

[2] L. Greener, *Evolution and Revolution as Organizations Grow*, „Harvard Business Review” 1972, Issue 4, p. 37-46.

[3] I. Adizes, *Corporate Lifecycles: how and why corporation grow and die and what to do about it,* Prentice Hall, Englewood Cliffs 1998.

to the enterprise's life cycle model proposed by Adizes, companies are „experiencing" their childhood, adolescence, rapid growth, the period of stabilization and old age. Adizes argues that at the beginning, they mostly do not think about strategic guidelines, operate according to a spontaneous strategy, there is no planning system; owners try to focus on efficiency. And if an enterprise starts to be interested in strategy, it means that it has passed its childhood stage.

Each of the stages of the life cycle is characterized by its inherent problems and priorities that impose an imprint on financial activity. We interpret the financial activity as:

- activities aimed at capital formation of the enterprise;
- activity on management of financial resources of business entities;
- activities to create the necessary conditions for business development;
- the system of using various forms and methods of financial support for the functioning of enterprises.

When comparing an enterprise with a living organism, we can say that finance is a blood system of an enterprise and provides the formation and „transportation" of assets to the relevant systems of vital activity of the enterprise. In general, agreeing with the crisis theory of enterprise development, as a living organism or system, we consider it appropriate to highlight the specifics of financial decisions that are made at each stage of the enterprise's life cycle, namely the stages of birth, stability and decline.

At the stage of birth an investment decision is made – one of the most important business initiatives of owners and managers, since investments determine the allocation of financial resources for a relatively long period. At this stage, the enterprise is determined by the strategy of financing fixed capital – from the conservative (when fixed capital is financed by its own funds and long-term loans) to aggressive (when short-term loans are involved in financing fixed capital). The latter is rare, that is, the main sources of financing are private sources – the owners' funds. At the birth stage, incomes of the enterprise are small, profits are minimal, or absent altogether. Often, the main management tool at this stage is the financial plan, which takes a special place in the business plan.

Growth is characterized by a stable positive dynamics of income indicators, however, and the cost of the enterprise is significant, especially on marketing promotion of sales. At this stage, the search for additional resources is necessary to increase production volumes. However, attraction of borrowed funds should not cause excessive increase in financial risk, which will make the enterprise sensitive to the impact of negative internal and external factors.

At the stage of birth and growth, the enterprise strives to achieve and exceed the profitability threshold, recover initial costs and move to the profitability zone.

Stability is characterized by the relative stability of sales over a long period, which provides the enterprise with stable profits. At this stage, the priorities should be to optimize their own and borrowed sources to maintain financial sustainability, develop a rational dividend policy that would, on the one hand, satisfy the owners, and, on the other hand, facilitated the accumulation of funds for modernization, technological upgrading, diversification of activities. Since stable financial results have a positive effect on the creditworthiness and investment attractiveness of an enterprise, this stage is most favorable for attraction of borrowed capital, realization of investment and innovative activity. At the stage of stability, it is important to ensure a stable high return on investment, the level of which cannot be lower than medium-sized, otherwise the process of outflow of investors will begin, which will signal the beginning of the last stage – a decline.

The decline is primarily driven by a declining sales and profits dynamics, and problems with financing current activity. There are various scenarios for the development of events, depending on the strategic goals of the enterprise – from transformation, adoption of non-standard managerial decisions to rehabilitation, reorganization or liquidation. Ultimately, the downturn may end either by the collapse of the business or its rebirth. In any case, the development of events will require well-balanced and sound financial decisions. Table 1 summarizes important aspects of the enterprise at different stages of the life cycle.

Table 1. Characteristics of the enterprise's life cycle stages

Features of the Stage of Life Cycle	**Stage of Life Cycle**			
	Birth	**Growth**	**Stability**	**Decline**
Goal and the main priorities	Search for its own market niche and the formation of competitive product advantages	Increase market share and maximum satisfaction of the needs of the target group of consumers	Growth of the market value of the enterprise	Solving current problems
Sale volumes	Small	Gradually and continuously increasing sales volumes	Relative sales volatility	Reduced sales due to falling demand and increased competition
Methods and tools of management	Single management	Delegation of authority	Project management	Bureaucracy

Features of the Stage of Life Cycle	**Stage of Life Cycle**			
	Birth	**Growth**	**Stability**	**Decline**
Priorities of financial activity	Optimization of investment decisions; analysis and evaluation of financial feasibility of project realization, search of a stable source of financing	Financing of marketing activities; search for additional resources needed to increase production volumes; efficiency of distribution and use of financial resources	Optimization of the ratio of own and borrowed resources, use and accumulation of profit	Achievement of a satisfactory financial condition, or carrying out an assessment of the value of the property complex for resale
Investment activity	Determination of optimal sources, methods and conditions for capital formation	Investing in the development of the material and technical base and capacity building	Capacity analysis of the implementation of new investment projects, diversification of activities	Collapse of its own investment programs, assessment of the market value of the enterprise
Innovative activity	Generation of a promising business idea that will be the basis of entrepreneurial activity	Innovative activity aimed at product improvement	Innovation activity orientation towards new business projects	Reduction of attention to innovation (in terms of business clutter) or the search and implementation of innovations that will help to revive business
The main sources of financing	Internal - owners' funds	Internal - profit	External - loans	Mixed - balancing external and internal sources
Priority directions of the use of financial resources	Formation of technical and technological basis of enterprise	Financing marketing activities aimed at increasing demand	Capital investments aimed at new markets or new business	Current financing needs of the enterprise
Dynamics of financial results	Income is small, profits are minimal, or absent	Profit growth	Stability of profits	Slow profit dynamics
Type of financial strategy	Selection of financing strategy	Strategy of financial support of accelerated growth	Strategy of financial support of sustainable growth	Anticrisis financial strategy

Source: developed by authors

It should be noted that these aspects are largely interconnected and interdependent.

Thus, the results of innovation determine the directions of investment of funds, the volume and dynamics of financial results will affect the decision on the appropriateness of attracting borrowed funds, etc. The table was built on the basis of statistical observations of the activities of Ukrainian enterprises[4] and interviews with entrepreneurs[5].

An important characteristic of the life cycle stages is investment activity, its financing and efficiency. The starting point for justifying investment decisions should be innovation, the implementation of which can provide the enterprise with a new quality and impetus for development. Innovation should be perceived by the enterprise as the basis of its survival in a competitive environment. The effectiveness of innovation activity is one of the factors that determine the trajectory of the life cycle curve. Thus, insufficient attention or ignoring of innovation activity reduces the duration of the stage of maturity and accelerates the stage of decline. It should be noted that innovations include not only technical and technological developments, the development of new products and services, but also the search and use of new forms of business, new methods of market activity, and new financial instruments. At the same time, systematic innovative activity requires significant funds – investments, and there is a high level of risk, as the positive result of innovation activity is difficult to predict. Thus, the efficiency of spending financial resources on the implementation of innovation and investment activities is determined primarily by the professionalism of managers, their ability to analytical and predictive assessments.

It should be noted that most of the components of the table coincided with the characteristics of the enterprises at different stages of the life cycle, inherent in economically developed countries. However, significant differences were found in the diversity of funding sources in Ukraine and other countries. Thus, a large-scale survey of enterprises in the OECD countries has revealed specific sources of funding, which vary in each of the stages of the life cycle[6]. At the stage of Birth, it is the means of entrepreneurs, subsidies (irreversible financial assistance), the funds of relatives, friends, business angels and support from incubators. Then strategic investors can join them. At the Growth stage loans, equity, venture capital and mezzanine financing are used.

At Stage Stability, it is proposed to co-operate with the investment banks or raise equity capital. At the stage of the Decline instruments of venture and mezzanine finance, possible mergers and acquisitions, as well as return from public to private property become again relevant (see Fig. 1).

[4] O. Sych, I. Pasinovych, *Consolidation of financial resources for postindustrial cities revitalization* / „Economic Annals" 2015, vol. XXI, № 9-10, p. 87-90.

[5] *Doing business - Measuring Business Regulations*, http://www.doingbusiness.org/data/exploreeconomies/ukraine [access 29.06.2018].

[6] K. Wilson, F. Silva, *Policies for Seed and Early Stage Finance: Findings from the 2012 OECD Financing Questionnaire*, „OECD Science, Technology and Industry Policy Papers" 2013, No. 9, OECD Publishing, http://www.ac.dk/media/423711/policies-for-seed-and-early-finance.pdf [access: 29.06.2018].

At the same time, Ukrainian enterprises are limited in funding sources, more than 60 percent are financed by their own funds – reinvested profits, avoiding loans (due to their high cost)[7]. Stock market institutions are poorly developed; mezzanine financing is not used.

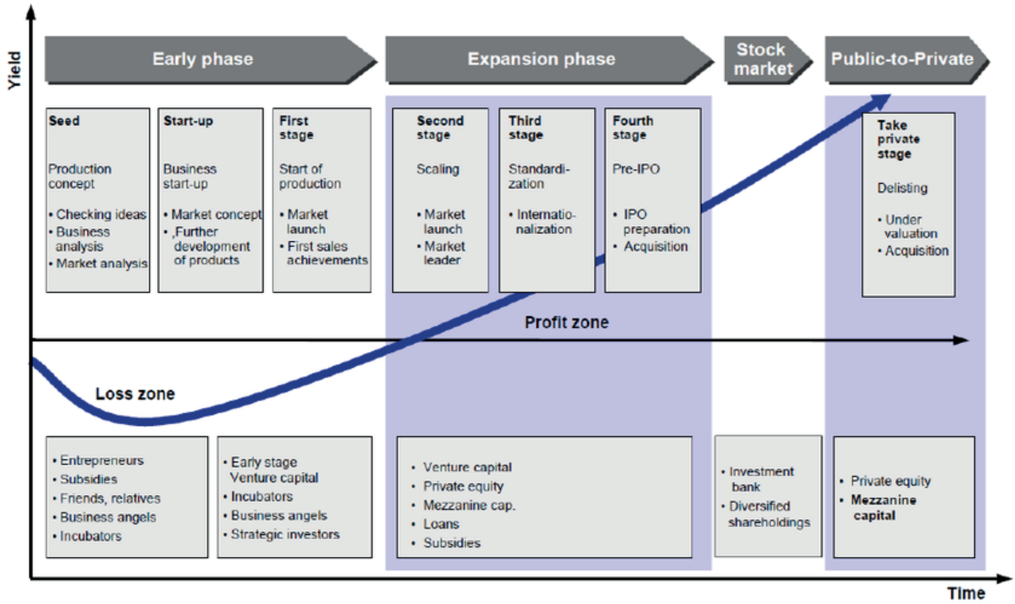

Figure 1. Life-cycle of a firm and stages of financing

Source: K. Wilson,, F. Silva, *Policies for Seed and Early Stage Finance: Findings from the 2012 OECD Financing Questionnaire*, „OECD Science,Technology and Industry Policy Papers" 2013, No. 9, OECD Publishing.

As the market develops, the enterprise's orientation towards goods and resources is gradually changing with interest in finance; the issues of financial management efficiency, in particular, cash flow management, the formation and use of profits become a priority. The key to investment decisions is the financial position of the enterprise and the dynamics of the financial indicators system.

The financial strategy of the enterprise includes the following elements: financing strategy, investment strategy (reinvestment) and functional strategy. Based on the financial strategy, the enterprise builds an appropriate policy that guides itself in future activities. Figure 2 depicts the main priorities of financial policy at each stage of the life cycle of the enterprise and a list of financial indicators – indicators, which are the focus of attention when implementing the selected financial strategy.

It should be noticed that there is a group of financial indicators that determine the financial sustainability of the enterprise and, therefore, are at the center of attention at all

[7] I. Yasinovska, S. Smolinska, *Market or banking services in the system of international economic*, „Economic, Finance, Law" 2016, № 2, p.12-15.

stages of its life cycle – these are indicators of solvency and liquidity. At the inception stage, these indicators are usually low, and then there should be provided a growing dynamics of their values and fixation at an acceptable size for a particular industry. Sufficient solvency is a prerequisite for achieving the enterprise's creditworthiness and investment attractiveness, which facilitates solving the problem of financing activities.

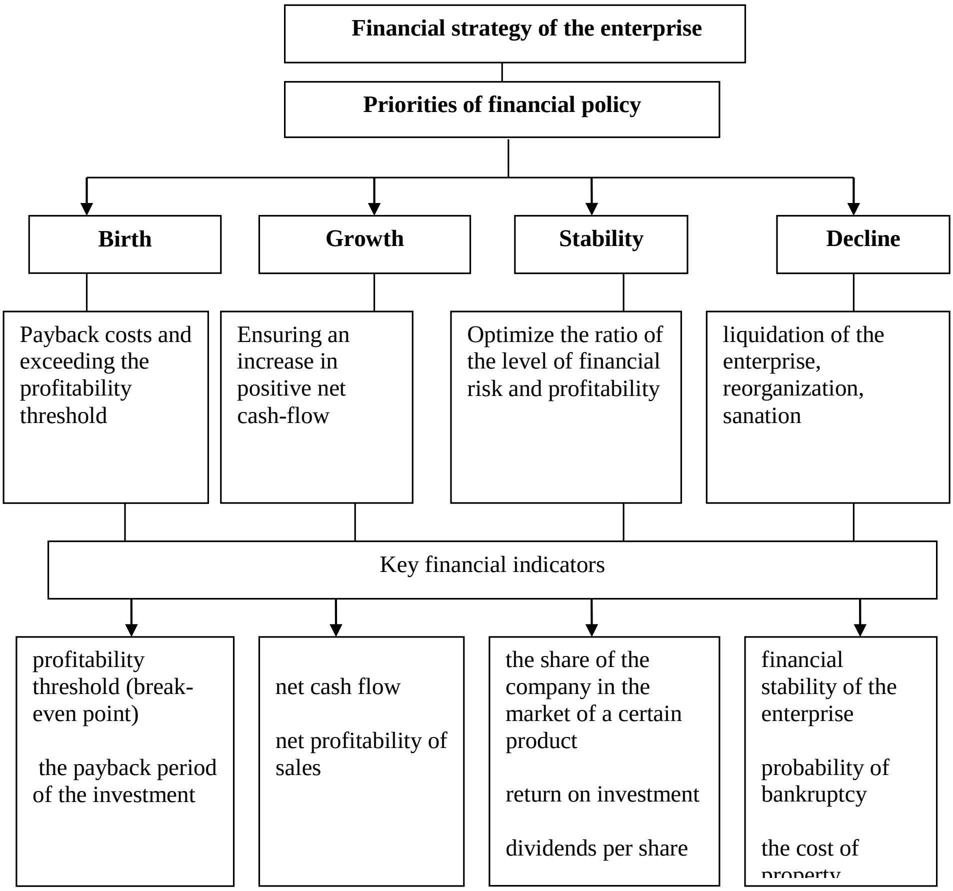

Figure 2. Objectives and effectiveness of the enterprise's financial strategy
Source: developed by authors

The transition from one stage of the life cycle to another is usually accompanied by a crisis. A crisis approach to the analysis of the life cycle of an enterprise suggests that every stage in its development is a peculiar crisis caused by external or internal factors. And that enterprise will remain „afloat", whose managers identify it in time, will be ready for change and take decisive steps to overcome it. Thus, it can be argued that one of the reasons for the unsatisfactory financial situation of most enterprises is the low level of financial management, in particular risk management. It is the unskilled and erroneous actions of the management that has led many businesses to break the financial sustainability or to the stage of bankruptcy. There may be an impression that the diagnosis of a financial state at a separate stage in the life cycle will allow us to form a successful financial strategy.

However, financial analysis is just the initial stage, the „top of the iceberg". The key factor that increases the likelihood of making false management decisions is the lack of a controlling system as the latest concept of effective enterprise management, which aims to ensure its long-term existence on the market. The control system synthesizes elements of accounting, planning, analysis, control, implementation of which ensures the development of alternative approaches in the strategic management of the process of achieving the ultimate goals and results of the enterprise.

Conclusions

The basis of stable operation and development of the enterprise in the dynamic conditions of market relations is an effective strategy, developed by senior management, taking into account a number of internal and, above all, external factors. And the more powerful the enterprise is, the more resources it uses, the more urgent it is for it to solve the problem of the formation and implementation of the financial strategy. The strategy should be aimed at ensuring the survival of the enterprise in the long run term due to the establishment of a dynamic balance with the external market environment.

The financial strategy covers all areas of financial activity: the choice of sources of funding and their optimization, optimization of the size and composition of fixed and circulating assets, the formation and distribution of profits, cash settlements and investment policy, methods of ensuring financial stability and sustainable development of the enterprise.

Formation of a financial strategy is a condition for the successful functioning of any enterprise, regardless of size, organizational and legal form and type of activity. The content of the financial strategy reflects the goals, the objects of management that are in priorities for a particular subject of management, on which its stability and development prospects depend. When small businesses put financial resources at the center of financial strategy, it helps to enlarge investments, improve capital structure and financial risk management.

When making strategic decisions, in particular in the financial sphere, it is necessary to take into account the stages of the life cycle, which differ primarily in the level and dynamics of business activity – volumes of production and sales, profitability of activities, as well as styles of competition, applied managerial technologies. Each of the stages of the life cycle is characterized by its inherent problems, priorities and risks that impose a reflection on financial activity. On the other hand, certain decisions in the financial plane can change the trajectory of the life cycle curve, in particular, continuing or reducing the stage of stability. In the conditions of the instability inherent in the Ukrainian economy, enterprises should focus on diversifying sources of funding and finding alternative business support instruments for example, business angels, venture capital and mezzanine financing.

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