

Creating Successful Management through Risk Exposure Detection and Access to Finance of the Company

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Abstract

Many transition and developing countries, in particular face a need to promote and strengthen the long term development of the SME sector, which requires access to market opportunities, as well as to new technology and management know-how, often in a situation of considerable resource scarcity. The domestic industry by using knowledge, innovation development and upgrading the capacity of the small and medium enterprises can take the necessary changes for its output and increase export performance. All of this can contribute to sustainability of the economic growth and economic integration especially of small and open economies.

Firms can choose to manage their exposures through business practices. Where contracts are concerned business can also set up clauses that reduce this exposure. In many cases this comes businesses also agree on setting all contracts in their core currency, protecting them from any exposure as they always are paid the same relative amount. Using calculations and SPSS software, this paper aims to focus on contribution for developing financial strategies that could help to strengthen the SME sector in a way to record benefits. Implementation of good strategies should increase the attractiveness in transition and developing countries for foreign investors which will improve the capacity of the companies.

Keywords: *exposure, finance, SMEs, strategy, EBIT, Macedonia.*

1. Introduction

In recent years, investments in international financial securities have grown significantly among individual and institutional investors. Broadening portfolios beyond domestic borders may help investors achieve greater diversification. Although the rapid growth in international investments reflects the benefits of geographic diversification, currency risk can counteract some of these advantages. Since foreign exchange rates can have a significant impact on returns, investors may be interested in hedging this risk where possible and appropriate. Investments in overseas instruments, such as stocks and bonds, can generate substantial returns and provide a greater degree of portfolio diversification, but they introduce an added risk, that of exchange rates. Since foreign exchange rates can have a significant impact on portfolio returns, investors should consider hedging this risk where appropriate. While hedging instruments such as currency futures, forwards and options have always been available, their relative complexity has hindered widespread adoption by the average investor (Boskov and Bishev, 2014).

Globalization has the potential to offer SMEs in developing countries with access to a global pool of new technologies, skills, capital, markets and hence faster export growth and profits than ever before. At the same time, globalization brings a lot of trade challenges and increase in competition from imports and the entry of new foreign investors for SMEs in domestic markets. SMEs have to adjust to the competitive strategies of MNCs in different countries, to public and privately set standard, to changes in international tastes, prices and competitive conditions (Boshkov and Kokaroski, 2014).

Wignaraja (2003) suggests that globalization opens up new opportunities for export expansion and growth to about 5-10% of SMEs in developing economies. These SMEs which are very dynamic today, have designed well-adapted marketing strategies and invested in manufacturing capabilities to bring them up to world standards of price, quality and delivery, hence complying with new technical, environmental and labor standards in

export markets. Such SMEs have expanded their existing domestic market shares, broken into new export markets and continuously upgraded their products and processes. Experience show that exporting SMEs from developing countries have proactively upgraded themselves.

2. Company exposures in Macedonia

Refinancing risk is significant for Macedonia meaning that it will need to repay PLL purchase in 2014 to 2016 and the bank loan guaranteed by the World Bank PBG in 2016. The volatility of the market has been high since the onset of the global crisis, due to external rather than domestic factors ((Bishev and Boshkov, 2016a).

This was case in 2009. In that time, the government issued a 3½-year Eurobond at a yield of 9½ percent which is more than double the 4% percent yield of the 10- year issuance in 2005, and in 2010 when it canceled a planned Eurobond issuance after market rates spiked in the run-up to the Greek program. Domestic debt features average maturity of just 6 months, and hence the need to roll over existing debt on average 2 times per year (Bishev and Boshkov, 2016b).

Increasing domestic non FX-indexed denar issuance could be way for gradually reducing SMEs exposure to currency risk in Macedonia. Data show that all external debt is in FX and half of outstanding domestic government debt is FX-linked. Big share of general government debt is hence denominated in or linked to foreign currency (90%).

It is known that currency risk is the high exposure multiplied by the low probability of a shock. But taking in account that we have stable exchange rate regime which is pegged, currency risk may not appear high.

Reducing currency risk would add to policy flexibility in the event of unforeseen shocks in the future. When the share of domestic denar-denominated is gradually increased, then the debt which is FX-linked would be a prudent strategy together

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with increasing the share of domestic debt in fiscal financing. These will bring benefits like developing the domestic currency yield curve, improving the monetary policy transmission mechanism, and greater use of denars in financial transactions (Boshkov and Bishev, 2016c).

If this medium-term strategy is following along these lines and developing too, achieve the goal of minimizing medium-term costs subject to keeping risks within appropriate pre-set bounds. By these steps market development will renew. Also it is known that in an economy when domestic yield curve is developing this would yield positive externalities. Translate for Macedonian economy means that it will establish a denar yield curve used in private sector loans and bonds. Traditionally, Macedonia has had low fiscal deficits, ranging from -1% to +1%, but during the crisis in 2009 this grew initially to 2.5% then to 2.8% with our highest in 2012 at 3.8%. In 2013, due to the financial stimulus were at 3.5%. Thus, NBRM was able to mitigate successfully because Macedonian public debt was low at around 20% of GDP which afforded us room for expansion which is used during this crisis period (Bogov, 2013).

The crisis with the Euro as a currency helped boost confidence in Macedonian domestic currency [MKD denar], because people began to wonder what would happen with Euro. In Macedonia people save and use credits in Euros. This give the right to say that Macedonia is highly Euro-rized country. As reports showed the propensity of households to save in MKD elevated to 50% (Boshkov and Dimeski, 2015).

3. Methodology

The study involved a field survey conducted in January 2016, by applying a self-administered questionnaire which was distributed among the managers and employees in companies in Macedonia. The survey contained questions on accounting exchange rate exposure. The aim was to collect data and to examine the behavior of enterprises. The analysis is based on descriptive statistics and probit and ordered probit regressions. Also, here are investigated managers' attitudes about the impact of business strategies on the intended financial strategy.

In 62 companies we asked managers what encourages and what limits the use of debt (Boshkov and Bishev, 2016a):

- High volatility of EBIT (high business risk) limits the use of debt (lower financial risk);
- Diversification (operations in more businesses) encourages the use of debt;
- Internationalization (sales in other countries) encourages the use of debt;
- Long periods of collection of accounts receivable force the use of debt.

4. Analysis, results and discussion

Enterprises are required to count export revenues and import expenditures. SMEs may have FX income or expenditure

from non-foreign trade type activity or they may have FX balance sheet items. This distortion is higher for FX assets and liabilities than for income statement items. On the other hand, the exchange rate exposure perceived by firms is underestimated as a result of low volatility of the exchange rate in the period before the survey. Firms could very easily project the future to felt is here any exchange rate risk or not (Boshkov and Bishev, 2016b).

Currency mismatch (CM) is defined as follows (Loderer and Pichler, 2000):

$$\text{Stock CM} = \text{MKD value of FX assets} - \text{MKD value of FX liabilities}$$

$$\text{Flow CM} = \text{MKD value of FX income} - \text{MKD value of FX expenditures}$$

If there is a negative currency mismatch, depreciation of the domestic currency would have negative effect, and the opposite is that appreciation would influence the net position positively.

The other scenario is the possibility that SMEs could have exchange rate exposure if the currency mismatch is zero; there is difference in the scheduling of outflows and inflows.

The survey responses about the impact of business strategy on intended financial strategy are summarized in Table 1 (Bishev and Boshkov, 2016d).

The greatest number of managers see EBIT volatility as the most important factor of applied business strategy that influences decisions about borrowing: 64.27% believe it is an important or very important factor (mean 3.807). EBIT volatility can be viewed as a synthetic indicator of business risk in terms of implemented overall business strategy. This indicates that managers are well aware of the need to combine the effects of business and financial risks meaningfully. In contrast to the views on diversification and internationalization, managers believe that a very practical problem is an important or very important factor of business strategy that determines the level of debt: delay of buyers in meeting their liabilities to the company. More than 65% of managers agreed with this assessment (a mean of nearly 3.6). We found additional statistically significant differences in attitude between managers of small and large companies in terms of how managers see impact of internationalization on level of debt (3.170 versus 2.520). Managers of small companies also believe more than managers of large companies that diversification encourages the use of debt (2.725 versus 2.176). Finally, not only managers of small companies but also managers of non-internationalized companies and diversified companies are more inclined to believe that internationalization encourages use of debt. One possible explanation is that managers of small firms find that diversification requires a significant investment that cannot be provided through internal financing and it is necessary to arrange additional borrowing for this purpose (Boshkov and Bishev, 2016e). The view of internationalization that managers of diversified firms have may be influenced by their experience of additional borrowing to extend product scope (i.e., diversification), leading them to conclude that additional borrowing is also necessary when it comes to extending geographical scope (Bordo et al., 2009).

Table 1. The impact of business strategy elements on financial strategy

	% of companies		Mean										
	Important or very important	Un important or with little importance	All	Size		Industry		Internationalization		Diversification		Debt	
				L	S	FP	O	N-I	I	UnD	D	UnL	L
Volatility of EBIT	64.27	3.15	3.807	3.795	3.914	3.935	3.790	3.680	3.987	3.685	3.990	3.675	3.880
Diversification	17.23	48.40	2.463	2.176	2.725*	2.454	2.564	2.503	2.572	2.280	2.803	2.286	2.607
Internationalization	37.15	31.05	2.807	2.520	3.170*	2.713	2.983	3.092	2.816*	2.542	3.365*	2.647	2.925
Slow paying by buyers	65.45	8.05	3.601	3.318	3.860*	3.565	3.725	3.680	3.694	3.423	3.928	3.452	3.698

* significant at the 0.05 level.

Source: Authors calculations.

Generally, in developing countries there is no developed market of term rates to use this tool. Namely, as an instrument to mitigate foreign exchange risk can serve the following rule - if the company does not generate income in the same currency as the loan is, repayment capacity of the loan should not exceed 50-60 EBIT of the company. In the case of depreciation, the company has the capacity to back the loan. So, those countries which are small and open (as Macedonia) have high indicator on protection of the EUR currency risk through their export (Boshkov and Bishev, 2016c).

5. Conclusion

Evidence shows that SMEs can face difficulties in financing international activity, identifying opportunities and making appropriate contacts in their target markets. Organizations have to evaluate the risks of doing business on an international level.

The majority of companies interviewed are not prepared for changes in the exchange rate. On the basis of their answers, most of SMEs with exchange rate exposure do not assess their exchange rate exposure or deal with its magnitude, and generally believe that they have no exchange rate exposure or that it is negligible. foreign exchange debt, as a means of natural hedging, may reduce exchange rate exposure, but if foreign exchange indebtedness is motivated by the reduction of costs (i.e. payment of lower interest rates upon borrowing, for example), the exchange rate exposure of the enterprise will grow. Several questions were posed in connection with assessing exchange rate exposure, expectations regarding the potential impact of the exchange rate on profitability, income, costs, debt and competitive position (Boshkov and Bishev, 2016d). Enterprises were asked to express their expectations on both the effects of

appreciation and depreciation, as exchange rate exposure may be asymmetrical. Half of firms with non-zero CM gave answers, based on which it is clear that they are not aware of the existence of exposure or deem it to be insignificant. About 50% of these firms do not expect the exchange rate to affect any of the aforementioned variables. The other half of this group said they had exposure, but they do not manage it or the answers are contradictory. For example, firms answered that they had no exposure but expected they would be influenced by a change in the exchange rate.

In general, developing countries – the Balkan countries have a shortage of savings and they imported foreign savings. Companies in Macedonia tend to borrow in foreign currency-Euro which is particularly popular in Serbia and Croatia, due to the lower interest rates compared to interest rates on credits in national currency. Differences in interest rates are an indicator of expected future depreciation / appreciation currency in terms of fluctuating exchange rates. The currency risk can be hedged in two ways: if the company is a net exporter and lend in currency of the net exports, or in short-term loans, if agreed today a term exchange rate to repay the loan at the time of the mature. But, in the Western Balkans as we have seen from the above researches there is no developed market of term rates to use this tool. Namely, as an instrument to mitigate foreign exchange risk can serve the following rule – if the company does not generate income in the same currency as the loan is, repayment capacity of the loan should not exceed 50-60 EBIT of the company. In the case of depreciation, the company has the capacity to back the loan (Boshkov and Bishev, 2015). So, those countries which are small and open (as Macedonia) have high indicator on protection of the EUR currency risk through their exports in Euros. These sectors can avoid currency risk by borrowing in Euros. **Q-as**

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