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CONSISTENCY OF AIMS A METHODS IN THE PROCESS OF FINANCIAL PLANNING IN THE COMPANY

Базою для створення довгострокового фінансового плану є формулювання фінансових завдань компанії. Добре сформульований фінансовий план повинен бути погоджений з іншими частковими планами компанії, який не є якоюсь окремо взятою діяльністю. Він повинен також забезпечувати бажані і взаємні зв'язки між структурою бюджетного капіталу і фінансовими рішеннями. Взаємозв'язки повинні бути сформульованими між проектами розвитку компанії, дивідендною політикою, проблемами оптимізації структури капіталу.

Як забезпечити потрібні взаємозв'язки між цими частковими планами? Як формулювати і виконувати ці часткові завдання? Чи можна їх взагалі узгодити? Чи є якісь варіанти їх вирішення в теорії і практиці фінансового менеджменту? Це ті актуальні реальні проблеми, з якими стикаються менеджери фінансових компаній.

The basis for creation of long-term financial plan is formulation of financial aims of the company. Well formulated financial plan has to be consistent with other partial plans of the company and does not represent separated activity. It should ensure also desirable and mutual relations between budget-capital structure and financial decisions. Mutual relation has to be formulated between company development projects, dividend policy, problems of optimizing of capital structure and share issuance policy and dept.

How to secure the desirable mutual relations between these partial plans? How to formulate and fulfill these partial aims? Are they consistent at all? Is there is any solution in the theory and practice of financial management? These all are real actual issues with which the financial company managers are confronted.

1. Definition of problem. The background for the long-term financial planning is relevant formulation of the financial aims of the company. The financial aims have to be consistent with the other particular company aims and to reflect the general aim, it means, the grow of the market value of the company. It is necessary to consider, that financial plan is only partial part of the complexity in company planning. Financial aims must be in relation to other parts and activities of company.

Financial aims as the starting point for financial planning have to be in relation to the dividend policy of the company, capital structure and policy of share issue and depts. Grow of the market value of the company create the framework for other partial financial decisions. There is the question, how to ensure mutual relations among these partial aims. The partial aims need not to be consistent and there is no any clear advice in the theory or practice how to make it coherent. All these issues and questions have to be solved by the financial managers of the company. Formulation of the answers or solutions is complicated and not easy.

In the theory of the financial management are existing different theoretical approaches (schools) models and methods, which support finding f effective solution, but usually only for some or individual segments of the financial plan. Mainly appear models and methods for evaluation of development projects, influence of financial decisions on the economic effectiveness of the company or optimizing of the dividend policy. The mutual relation among these models is not well developed.

2. Optimal model of the anti-dividend approach. Justification of the optimal model of the anti-dividend approach is the search of the well balance point between rentability of the company and rentability of shareholder in the situation when is existing also alternative investment. It means that company will invest up to the point, when the level of shareholder rentability in comparison with the alternative investment will achieve rentability of the company. If the investment does not spend all financial resources, he rest can be used for redemption of dividends. If the curve of the rentability does not cross the curve of the costs of the victimized investment, there is no reason chance to pay dividends.

3. Signal model. The fundamental of the signal model can be simply described on example that also weak companies (with the low actual value of their projects) can pay high dividends and so to copy the successful companies. The problem is that potential investors will not believe to the published information and all companies in branch will be ranked as middling. Strong companies (to avoid this wrong evaluation), will be motivated to generate any signal (like payment of dividends), to show their financial force in the level, which the weak companies cannot follow. Use of the financial signal looks like wasting cash, but there is the hope, that in the situation of the good economical forecast, all these lost will be compensate, what we cannot expect in the situation of bluffing weak company.

4. Theory of compromise. Brealy, R.A. and Myers, S.C. created for decision making for optimal capital structure the theory of compromise. It means that they represented the option of capital structure like compromise between advantages of tax shield rate and costs of expected financial inconvenience.

The value of the company with debts is expressed by:

VCD = VC + AV RTS – AV FI

Where:

VCD = value of the company with debts
VC = value of the company financed from own financial resources (own capital)
AV RTS = actual value of the tax shield rate
AV FI = actual value of the financial inconvenience

Optimal capital structure is determined by the mutual relation between tax advantages and costs of financial inconveniences. In the case of low debts the costs of financial inconveniences are insignificant and advantages of tax shield rate are dominating. In certain point of debt level the probability of financial inconveniences is growing and these costs start to decrease the value of the company. Theoretical optimum comes in an instant when actual value of tax savings from further loan is compensate by the actual value of financial inconveniences.

5. Case studies. Balanced mutual relation between investment or financial decision making and recommendation for capital costs is possible to demonstrate in the long-term period on the three following examples.

Company „A“

Situation:

Company lifecycle is in the stage between development and growth and produced financial resource is invested to the development of the company. The projects are financed both from own and external resources. For decision making in dividend policy, there is opportunity to use the anti-dividend approach. The primal decision concerns the development projects and capital structure. Thus the dividend policy is residual.

a) Aims of the long-term financial plan:

- Development projects – expected is minimal profit it means ROCE (Return On Capital Employed) is ever positive.
- Capital structure – for determination of capital structure is applied „Theory of compromise“
- Dividends are accumulated
- Limit of capital expenditures - depends on the expected capital structure

b) Correction of modeling:

- Value of ROCE
- Volume of invested capital including external resources

c) Recommended application – simulation model

d) Evaluation of the project economic effectiveness:

- ***Calculation of adjusted net value, alternative costs of capital –Weighted Average Cost Of Capital (WACC)***

➢ Calculation of net value, adjusted alternative costs of capital – ***Weighted Average Cost Of Capital* (*WACC*)**

For evaluation of economic effectiveness of projects is possible to calculate WACC from actual values and come from expected (targeted) capital structure, it means that we must set up the period, in which we will make WACC calculation.

Company „B"

<u>Situation:</u>

Company lifecycle is in the stage of maturity. The company produces enough cash to pay dividends. The investment opportunities are reduced. The company applies the „Signal model" . Dividend policy and decision about the future capital structure are based on the „Theory of compromise". Projects are financed both from own and external resources. The prime decision is the decision about the dividends and capital structure. Decisions about the projects are residual.

a) Aims of the long-term financial plan:

➢ Dividends - assignment of dividend value (per 1 stock) and its growth is made according to the application of „Signal model"

➢ Capital structure – for target capital structure is applied „Theory of compromise"

➢ Development projects: minimal return - ROCE

➢ Limit of capital expenditures - based on the target capital structure

b) Recommended application of „Simulation model", methods for long-term planning, share on revenue etc.

c) Evaluation of the project effectiveness – like in the company „A"

Company „C"

<u>Situation:</u>

Company lifecycle is in the stage between development and growth and produced financial resources are invested to the development of the company. The projects are financed both from own and external resources. For decision making in dividend policy, there is used the anti-dividend approach. For decisions about the future capital structure the company applies the „Theory of compromise", it means, that target capital structure expects lower level of debts.

a) Aims of the long-term financial plan:

➢ Development project – expected is minimal profit it means ROCE (Return On Capital Employed) is ever positive.

➢ Capital structure – for target capital structure is applied „Theory of kompromise"

➢ Dividends – not paid

➢ Limit of capital expenditures - based on anti-dividend approach

b) Correction of modeling:

➢ Value of ROCE

c) Recommended application – models for long-term financial planning, simulation model

d) Evaluation of the project effectiveness:

➢ Calculation of actual net value, adjusted alternative costs of capital - ***Weighted Average Cost of Capital* (*WACC*)**

For evaluation of economical effectiveness of projects is possible to calculate WACC from actual values and to come from the future target capital structure, it means to set up the time schedule period for WACC calculation.

6. Conclusions. The application of above presented proposals can facilitate to formulate the goals for long-term financial planning with the correlation to other investment and financial decisions. The final decisions are based on the multi-criterion decision making, which is based also on other modern methods and models used for financial planning of the companies at all.

1. Brealey R.A., Myers S.C. Theory and practice of company finances. – Prague: Computer Press. – 2000. 2. Kralovic J., Vlachynsky K. – Financial management. – Bratislava: IURA EDITION. – 2006. 3. Megginson W.L. Corporate Finance Theory. Addison-Wesley: Longman Readings. – 1997.