UDC 338.488.2:653.14(497.7)
Original scientific paper

Marija ACKOVSKA[1])
Neda PETROSKA ANGELOVSKA[2])

STRATEGIES FOR FUNDING ACCOMMODATION AND FOOD SERVICE ENTERPRISES IN THE REPUBLIC OF MACEDONIA

Abstract

In the performance of business activities and goals, enterprises use different approaches in managing inventories, receivables, liabilities and cash. By applying a certain approach to management of current assets and current liabilities, companies try to reach the desired balance between profitability and risk.

By combining different sources of funding, companies have the opportunity to apply a variety of funding strategies during the work operations. As it is the case with all companies, so it is with the accommodation and food service enterprises in Macedonia. The application of each type of funding strategy has positive and negative effects on the companies' performance, and that brings a different level of risk. The financing strategies also depend on the financial targets that the enterprises have set.

The purpose of this paper is to show the potential sources of funding, which are available to companies. Furthermore, the aim is to describe the characteristics, advantages and disadvantages that each potential source of funding has. Moreover, the aim of this paper is to portray the sources of financing the accommodation and food service enterprises of Republic of Macedonia. In other words, the companies use already implemented strategies for financing and thus, it is possible to recognize the approach the companies from the service sector have against the risk and profit.

---

[1]) Marija Ackovska, Ph.D, associate professor, Institute of economics-Skopje, University "St. Cyril and Methodius" E-mail: marija@ek-inst.ukim.edu.mk
[2]) Neda Petroska – Anagelovska, Ph.D, associate professor, Institute of economics-Skopje, University "St. Cyril and Methodius" E-mail: neda@ek-inst.ukim.edu.mk

Keywords: financing, funding strategies, enterprises, accommodation and food service, Republic of Macedonia.

JEL Classification: G32

Introduction

Different strategies of financing have their positive and negative effects on the performance of companies, and bring different levels of risk. Using a strategy of funding depends on: the activities of the company, its size, the availability of certain funding sources, the targeted financial goals and growth the companies want to achieve, and the level of risk they are willing to undertake. Besides these factors, the choice of the financing strategy of an enterprise depends on the environment in which the company operates, especially in very complex national and international conditions of functioning.

When it comes to financing assets, companies can provide funds from various sources. Each of the sources of funding have certain advantages and disadvantages, so companies must determine the optimal structure of the sources of funding at certain time. Determining the right combination of funding, the actual strategy of funding is essential for companies. When choosing a specific strategy, the relationship between risk, return and liquidity is to be measured, because companies tend to choose the financing strategy that will optimize the relationship between profits and risk.

1. Definition and types of enterprises' funding strategies

When companies perform the business activities and accomplish the goals, they use different approaches[3] in inventory managing, demands, liabilities and cash. By applying a certain approach in management of the current assets and current liabilities, companies are trying to reach the desired balance between profitability and risk.

When it comes to financing funds, the companies can provide funds from various sources. Each of the sources of funding has certain

[3] Gallagher J. Timothy, Andrew D. Joseph: Financial Management (principles and practice), Prentice-Hall, 2006, p.484-485.

advantages and disadvantages and that is the reasons why companies must determine the optimal structure of the funding sources at the time. Determining the right combination of funding, the actual strategy of funding is essential for the companies. When choosing a specific strategy, the correlation between risk, income and liquidity is measured at first. That is why companies tend to choose a financing strategy that will optimize the relation between the profit and the risk.

The differentiation of certain strategies of financing the assets "starts from three assumptions: First, long-term sources of financial assets are more expensive than the short-term assets; Second, the profitability of the long-term sources is higher than the short-term sources; and Third, the risk of when the enterprise is financed with long-term funding sources is smaller than the short-term funding sources."[4]

There are three basic strategies in determining the combination of funding sources for the assets: aggressive strategy, conservative strategy and moderate strategy. Each strategy has positive and negative effects on the companies' performance and brings a different level of risk. Using a specific funding strategy depends on: availability of certain financing sources, the financial aims and the growth that companies want to achieve, with the level of risk they are willing to take in order to achieve the previously set aims.

1.1. Aggressive financing strategy

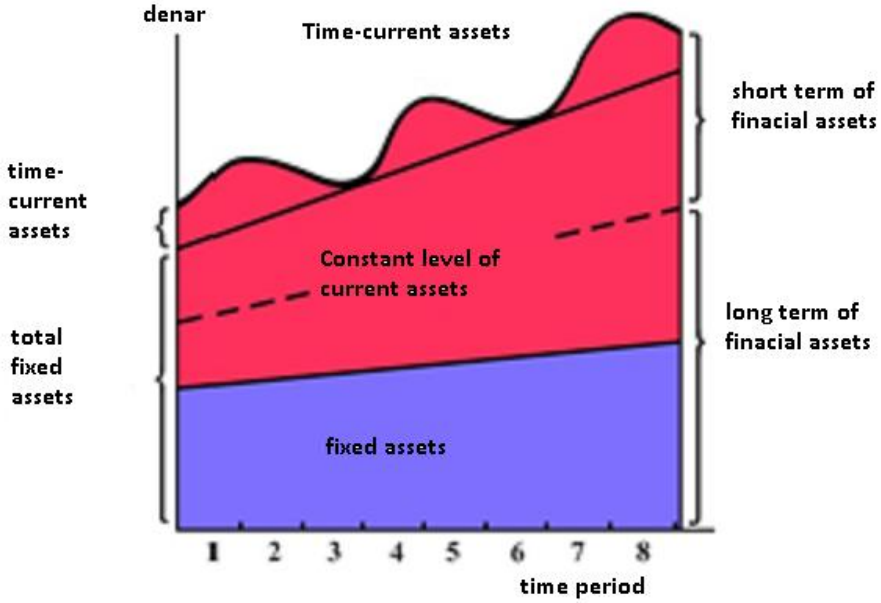
Aggressive financing approach means acceptance of greater risk by the company, pending the higher income.[5] Companies using this strategy keep a low level of liquid assets on their own because the aggressive approach involves keeping a minimum level of liquid assets in order to minimize the excess liquid assets. This situation increases the potential risk when all obligations should be paid out. In order to increase the income, the available liquid assets are invested in long-term assets. Besides the minimum level of liquid assets, companies also keep a minimum level of stocks. **By keeping the minimum level the stocks are constantly decreasing.** On the other hand, the risk of lower sale is possible because of the potential lack of stock when they are needed. When it comes to financing the funds using the aggressive strategy of

[4] Spasov S. Arsov S, Financing management, p.260.

[5] Brigham F. E., Ehrhardt C. M.: Financial Management: Theory and Practice, 13th Edition, Sout-Western Cengage Learning, Mason, 2011, p.645.

funding, it means using short-term funding sources for financing the total capital, partial financing or total financing of the permanent working capital and perhaps part of the fixed assets (Figure 1).

Figure 1: Aggressive funding strategy



Source: Brigham F. E., Ehrhardt C. M.: Financial Management: Theory and Practice, 13th Edition, Sout-Western Cengage Learning, Mason, 2011, p.646.

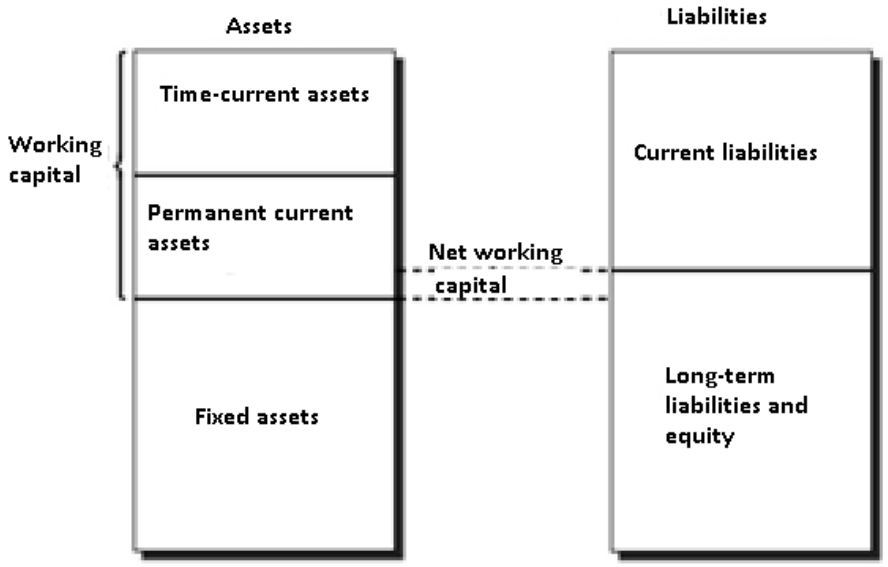
From the picture, it is evident that the aggressive funding strategy involves the use of short-term funding sources for occasional seasonal capital and even more for the permanent current assets. Moreover, the use of short-term funding sources using the aggressive funding strategy involves financing the permanent working capital and fixed assets. This kind of approach for financing current assets and a large part of permanent working capital from short-term sources apply lower costs of funding, but the risk increases when the funding is reducing the net working capital.[6]

Depending on the environment where the company operates, the dynamic generation of cash inflow and cash outflow and the appearance on different payouts and many other factors, makes keeping a small

[6] Net working capital (NWC) is calculated as current assets minus current liabilities.

amount of net working capital very risky for companies.[7] This is so because there is not enough cash between the amount of liquid assets and the amount of debt that has yielded in short term (Figure 2).

Figure 2: Net working capital in an aggressive strategy of funding



Source: Gallagher J. T., Andrew D. J. Jr.: Financial Management – Principles and Practice, Prentice Hall, New Jersey, 1997, p. 416

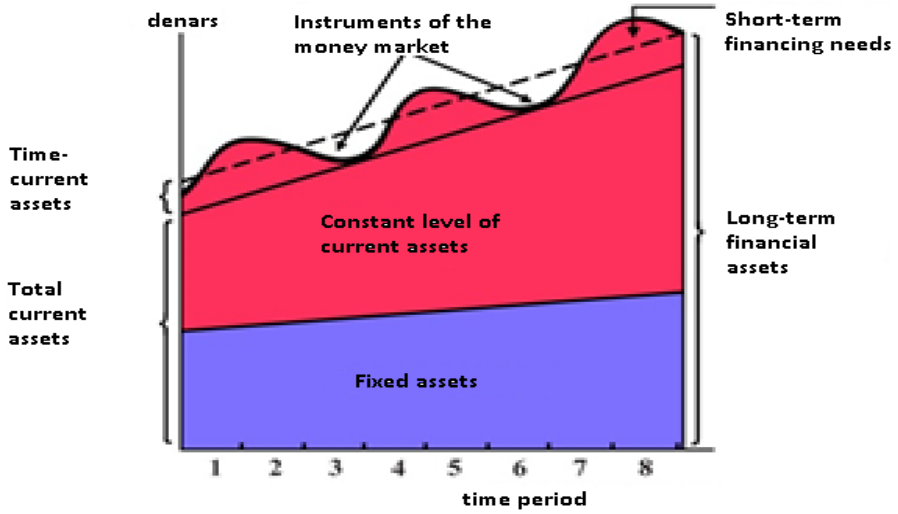
Companies can use more aggressive strategies from the ones portrayed in figure 2. In that case, despite the temporary working capital from short-term sources, it fully finances the permanent working capital. The net working capital will be at zero, the work is without security assets. Even more risky is the strategy that involves use of short-term sources of financing the fixed assets, which means creating a negative net working capital. This funding strategy is highly aggressive and the company could face major problems if loans are not renewed or if interest rates rises.

[7]Gallagher J. T., Andrew D. J. Jr.: Financial Management – Principles and Practice, Prentice Hall, New Jersey, 1997, p.416.

1.2.Conservative financing strategy

With the conservative financing approach, companies sacrifice parts of yield to be liquid. In other words, they have high amounts of financial assets and they store large quantities of stocks. Companies are protecting themselves from unexpected illiquidity because they have sufficient funds to pay for all their obligations and they have enough stocks to meet all the requirements. The conservative financing strategy means using the long-term sources to finance the fixed assets and the total current assets (permanent and temporary working capital). Short-term asset sources are intended only for the unforeseen and accidently increased current assets and they are intended to maintain the liquidity in the form of securities (Figure 3).

Figure 3: Conservative strategy of funding

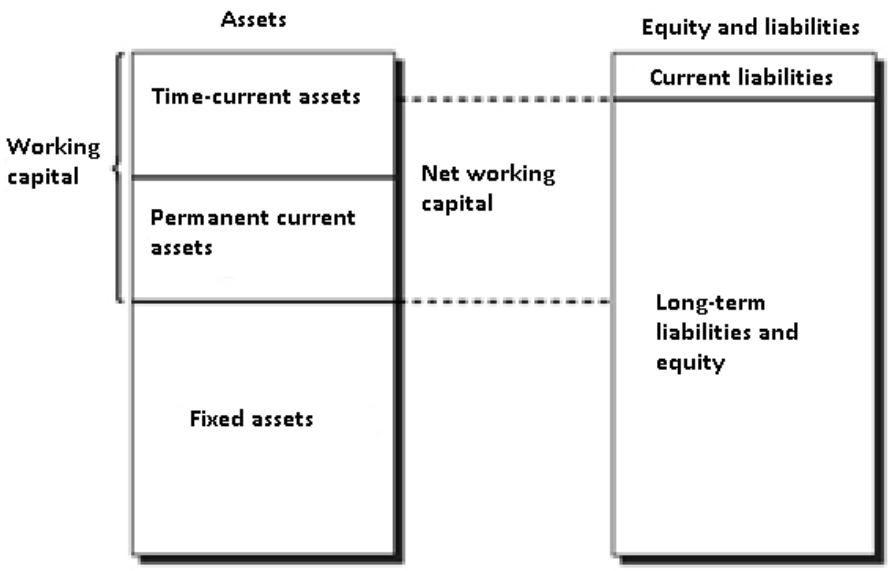


Source: Brigham F. E., Ehrhardt C. M.: Financial Management: Theory and Practice, 13th Edition, Sout-Western Cengage Learning, Mason, 2011, p.646.

It is evident that, given the conservative strategy of funding, all assets are financed by long-term sources. Only the amounts above the dotted lines are result of unforeseen needs for working capital and are financed by short-term financing sources. As a result, current assets exceed the current liabilities by a large margin and companies have a large amount of net working capital. The high amount of net working capital is relatively safe or it is at a risk-free position (Figure No.4)

because the enterprises have sufficient liquidity to be able to repay short-term debts.

Figure 4: Net working capital in the conservative strategy of funding



Source: Gallagher J. T., Andrew D. J. Jr.: Financial Management – Principles and Practice, Prentice Hall, New Jersey, 1997, p.417.

Same as the aggressive strategy, the conservative strategy inclused several types. The degree of conservativeness depends on the amount of the used long-term assets. The greater portion of long-term assets used in financing the current assets, the more conservative strategy is.

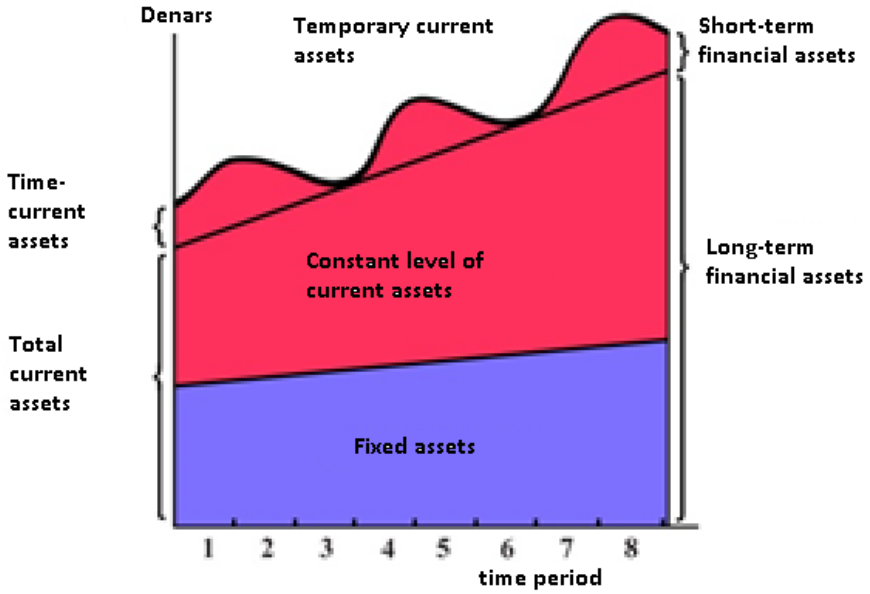
The conservative financing strategy is low-risk and relatively safe strategy. This strategy is most useful when the economy is in recession because the banks do not approve loans easily. In this case, companies that use conservative funding strategy will have sufficient liquidity to continue operating effectively, unlike the others, who will not be able to provide finances to purchase the necessary stocks, which will lead in reducing their business activities or being unable to pay out their employees. On the other hand, the security offered by the conservative strategy affects the income. Long-term financing is generally more expensive than the short-term financing and the company pays the

interest for funds that are not needed at a given moment. The use of long-term loans and capital to finance the necessary assets means engaging the financial assets that could be used in a more productive way.

1.3.Moderate financing strategy

The moderate funding strategy means that companies have an optimal attitude against the risk and the income. The moderate approach maintains the financial funds and stocks at a certain level, which is necessary to meet the enterprises' needs. This level is called "the permitted level" or a level that is close to the optimal one. When financing using the moderate strategy, known as a concept of equalization, means that the costs for the assets has to be equated with the time period for which those funds would provide an income (Figure 5).

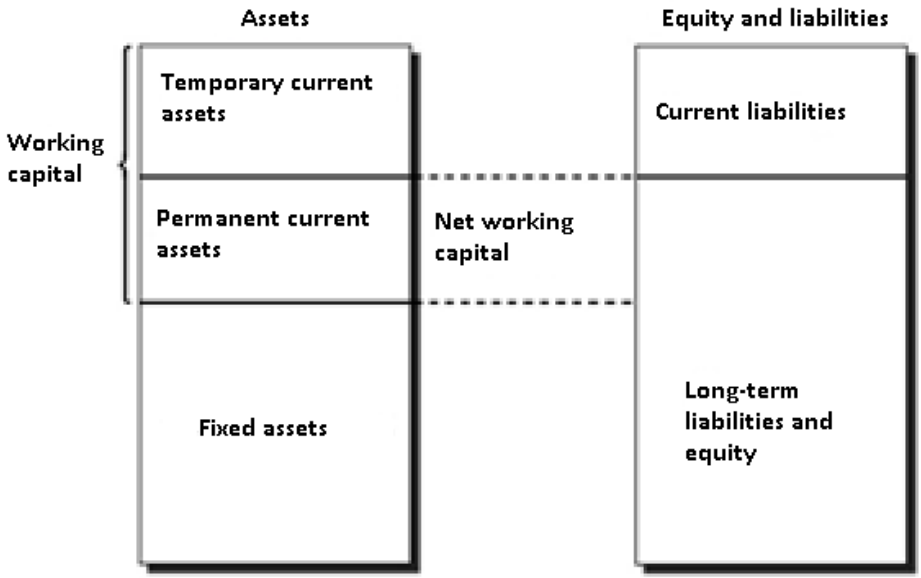
Figure 5: Moderate strategy of funding



Source: Brigham F. E., Ehrhardt C. M.: Financial Management: Theory and Practice, 13th Edition, Sout-Western Cengage Learning, Mason, 2011, p.646

It is evident that the enterprise's fixed assets and current enterprise's permanent assets are financed using long-term financing sources. Moreover, the enterprise's current assets are fully financed from the short-term financing sources. Moderate strategy implies equalization of assets with the fulfillment of all obligations (Figure 6). Also, the moderate financing strategy provides the enterprises with a reasonable amount of net working capital.

Figure 6: Net working capital in the moderate strategy of funding



Source: Gallagher J. T., Andrew D. J. Jr.: Financial Management – Principles and Practice, Prentice Hall, New Jersey, 1997, p. 418

In practice, it would very difficult to fully implement the moderate financing strategy, due to two factors. The first one is that the life of the assets is uncertain. The second one is that the enterprises have to use the common capital if they **do not reach the deadlines**. However, if the company applies the moderate funding strategy, or in other words it succeeds to reach the point of aligning the assets with the maturity of liabilities, then the case is about taking a relatively reasonable risk balanced with relatively reasonable expected income.

2. Empirical research of strategies for funding enterprises in accommodation and food service in the Republic of Macedonia

In order to perceive the situation about the company readiness when they expect a certain level of income and accept a certain level or risk, an empirical research was done. Thus, despite the theoretical approach for determining the operational approaches and financing strategies used by the enterprises in the accommodation and food service sector in the Republic of Macedonia, a quantitative research was also conducted. Data that are further analyzed in the paper are derived through research conducted by questionnaire in November 2014. The questionnaire was sent to 34 enterprises involved in accommodation and food service activities (selected randomly), of which 29 enterprises have provided the answers to the questionnaire .

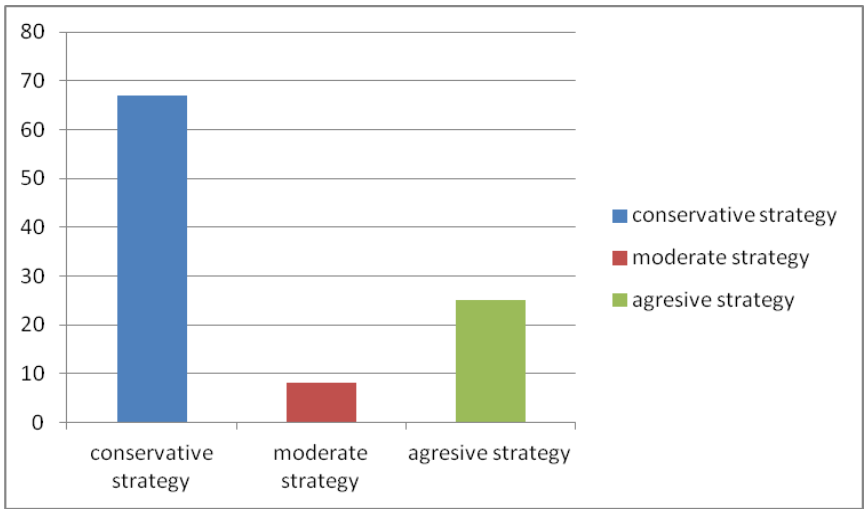
Due to the specifics of their activities, two-thirds of businesses in accommodation and food services, generally have low level of inventory and final products, or working capital at whole. One-third of enterprises have normal level of stock of working capital and final products. Most of these companies or 75% of them also keep a minimum level of liquid assets, while only 25% of them keep normal level of liquid assets . Just over 16% of the companies offer their customers restrictive payment terms, while a half of the rest of the enterprises provide normal conditions to their customers, and the second half provides flexible payment terms. More than 91% of companies have normal level of current liabilities, and only slightly more than 8% that have a minimum level of current liabilities. In order to pay current liabilities, a quarter of the companies do not need additional funds, about 67% of enterprises rarely need additional resources, and only slightly more than 8% often need additional funds to pay current obligations.

Businesses in accommodation and food services mostly use only their own funds to finance their operations. Namely, 42% of the companies use borrowed sources of funds, more than 60% of them use both short and long-term sources of funding, while the remaining 40% of the enterprises use both, short-term sources or only long-term sources of funding. Typically, more than 81% of these companies use their own funds or funds from long-term sources to fund ongoing working capital, while just over 18% of the enterprises use a large portion of funds received from short-term sources of funding for ongoing working capital.

Most of the enterprises finance their seasonal working capital using their own funds or funds from long-term sources, while short-term sources are used for funding seasonal working capital in 27% of the enterprises. Small section or about 25% of the companies say they sometimes use short-term sources for financing fixed assets, and no enterprises related to these activities invest in securities. The smallest part of all companies, or only a third of them are satisfied with their growth and development. Half of businesses are satisfied with the realized profit, but more than 67% of enterprises do not believe that they will earn a larger profit if they change the way of funding.

Because of the specifics of the enterprises in accommodation and food service activities, they are forced to apply an aggressive approach, less moderate approach and to avoid the conservative approach when working .

Chart 1: Strategies of funding enterprises in accommodation and food service activities



Source: Data obtained from research conducted

The results of empirical research present opposite situation when comes the question for financing assets (chart 1). Namely, two thirds of the companies or 67% apply conservative financing strategy, and more than 58% of companies use only their own finances or ultra conservative strategy. The aggressive strategy of financing funds use approximately 25 % of enterprises, while moderate strategy of funding more than 8 % of enterprises.

Conclusion

One of the most important decisions of the companies is choosing an appropriate way of funding. The success of the enterprises depends on whether they will be able to align their funding needs with the funding sources in a way that best suits their needs, because not all of the resources are appropriate for every company in a certain time. Sources of funding actually show how enterprises provide assets for their needs. Each separate source of funding has its own characteristics and therefore they are classified according to different criteria. Selecting certain sources of funding, i.e. a combination of funding sources, is an acceptance and implementation of a strategy of funding. Each enterprise tries to select such a financing strategy that at a given moment will optimize the relationship between profits and risk .

In general, because of the specifics of enterprises in accommodation and food service, enterprises are forced to apply an aggressive approach, less moderate approach and to avoid the conservative approach when working. In the Republic of Macedonia there is an opposite situation in the enterprises that provide accommodation and food services, where conservative strategy is dominant funding strategy. The results from the survey confirm the above mentioned conclusion, i.e. enterprises mostly use less risky and relatively safe strategy of funding.

- Very few enterprises use the moderate strategy of funding , which take moderate/reasonable risk and expect relatively reasonable yield,
- But some enterprises are willing to take risk, to exploit lower costs in order to make more profits i.e. aggressive strategy of funding despite the fact that the application of this strategy is not very common in such complex conditions.
- The majority of enterprises in accommodation and food service are financing only by their own funds, and some of them despite their own funds also use funds provided only by long-term sources.

It is evident that the benefits of running the conservative strategy of financing is most obvious when the economy is in transition, because then banks do not approve loans very easily. In that case, companies tend to use conservative funding strategy in order to have more reserves of liquid assets to avoid hindering the maintenance of continuity in its

operations, otherwise enterprises would not be able to fund its ongoing activities.

References:

1. Arundale K.: Raising Venture Capital Finance in Europe, Kogan Page Ltd, London, 2007.
2. Brigham F. E., Ehrhardt C. M.: Financial Management: Theory and Practice, 13th Edition, Sout-Western Cengage Learning, Mason, 2011.
3. Block B. Stanley, Hirt A. Geoffrey: Foundation of financial management, Mc Graw-Hill Irvin companies, 2008, New York.
4. Fabozzi J. F., Drake P. P.: Finance: Capital Markets, Financial Management and Investment Management, John Wiley & Son Inc, New Jersey, 2009.
5. Fabozii, Peterson: Financial Management & Analysis, Second Edition, John Wiley & Sons Inc., Hoboken, New Jersey, 2003.
6. Gallagher J. T., Andrew D. J. Jr.: Financial Management – Principles and Practice, Prentice Hall, New Jersey, 1997.
7. Gitman L., Zutter C.: Principles of Managerial Finance, 13th Edition, Prentice Hall, New Jersey, 2010
8. Horngren T. C., Harrison T. W. Jr., Oliver M. S.: Financial & Managerial Accounting, 3rd Edition, Pearson Prentice Hall, New Jersey, 2012.
9. Spasov S., Arsov S.: Financial Management, Faculty of Economics - Skopje, 2008.
10. Shim K.J., Sieghel G. J.: Financial Management, 3rd Edition, McGraw-Hill Inc, New Jersey, 2007.
11. Thukaram R. M. E., Accounting and Financial Management for BCA & MCA, New Age International (P) Ltd., Publishers, New Delhi, 2006.
12. Wild, Shaw, Chiappetta: Fundamental accounting principles 20th edition, McGraw-Hill/Irwin, New York, 2011.

WEB pages:

1. www.mse.mk
2. www.nbrm.mk
3. www.stat.gov.mk