

Denys E. Ponomarov¹

ENTERPRISE FINANCIAL STABILITY UNDER THE INFLUENCE OF EXTERNAL ECONOMIC FACTORS: UKRAINIAN REALIA TODAY

This article is dedicated to causes and mechanisms of the international credit ratings and external environment affecting the financial stability of companies in contemporary changing environment in Ukraine. Prerequisites for worsening of the sovereign rating of Ukraine, mechanisms of assigning credit ratings and grading scale are analyzed. Examples of the impact of external economic and political environment on financial stability and sovereign credit ratings as well as ratings of individual companies are provided.

Keywords: financial stability; political environment; creditworthiness; investment attractiveness; credit ratings.

Денис Е. Пономарьов

ВПЛИВ ЗОВНІШНЬОЕКОНОМІЧНИХ ФАКТОРІВ НА ФІНАНСОВУ СТІЙКІСТЬ ПІДПРИЄМСТВ: УКРАЇНСЬКІ РЕАЛІЇ СЬОГОДЕННЯ

У статті виявлено причини та шляхи впливу зовнішньоекономічного середовища через встановлення міжнародних кредитних рейтингів на фінансову стійкість підприємств в умовах сучасного мінливого середовища в Україні. Проаналізовано передумови погіршення суверенного рейтингу України, механізми присвоєння кредитних рейтингів та шкали оцінювання, наведено приклади впливу зовнішньоекономічного та зовнішньополітичного середовища на фінансову стійкість та міжнародні кредитні рейтинги як суверенні, так і рейтинги окремих підприємств.

Ключові слова: фінансова стійкість; політичне середовище; кредитоспроможність; інвестиційна привабливість; кредитні рейтинги.

Табл. 1. Літ. 23.

Денис Э. Пономарёв

ВЛИЯНИЕ ВНЕШНЕЭКОНОМИЧЕСКИХ ФАКТОРОВ НА ФИНАНСОВУЮ УСТОЙЧИВОСТЬ ПРЕДПРИЯТИЙ: УКРАИНСКИЕ РЕАЛИИ

В статье выявлены причины и пути воздействия внешнеэкономической среды путем установления международных кредитных рейтингов на финансовую устойчивость предприятий в условиях современной изменчивой среды в Украине. Проанализированы предпосылки ухудшения суверенного рейтинга Украины, механизмы присвоения кредитных рейтингов и шкалы оценивания, приводятся примеры воздействия внешнеэкономической и внешнеполитической среды на финансовую устойчивость и международные кредитные рейтинги, как суверенные, так и рейтинги отдельных предприятий.

Ключевые слова: финансовая устойчивость; политическая среда; кредитоспособность; инвестиционная привлекательность; кредитные рейтинги.

Introduction and literature review. In today's realia external environment plays an important role in the activities of any enterprise. One of the most important external economic factors is the political environment. Political environment in Ukraine which is currently very dynamic, has huge effects on credit ratings. Credit ratings

¹ European University, Kyiv, Ukraine.

have a significant value since they represent one of the most important tools used by investors while purchasing bonds or other investments with fixed income worldwide. These ratings are the permanent results of the rating agencies's thorough research according to the ability of the enterprise, company or authority, which acts as the issuer to promptly fulfill its financial obligations.

Also credit ratings are used to display the actual credit quality of certain debt obligations (corporate or municipal bonds) and their relative probability to default on such obligations.

Therefore, in the present conditions of changing political environment in Ukraine the issue of studying the essence and the influence of credit ratings on financial stability of companies is extremely important.

The following foreign scientists dedicated their research works to the issues of creditworthiness, financial stability and credit ratings: Brealey and Mayers (1997), Van Horne (1997), Brigham (1997), Lee and Finnerti (2000) and others. Among Ukrainian scientists, who have dedicated their works to the problems of determining creditworthiness, financial stability and credit ratings we must first of all mention Bandurko (2002), Kramarenko (2003), Kravchuk and Leschuk (2010), Tereshchenko (2003) and others.

The main purpose of this article is to study the influence of external economic environment on international credit ratings, which in turn impact on financial stability of companies.

Key research findings. Credit rating of any market participant is calculated on the basis of financial history, the estimated size of property and assumed liabilities. They are assigned in accordance with the desire and the ability to fulfill market debt. And, if a market participant is a country, this desire is the political factor and the ability is the economic one. The main purpose of these assessments is to provide potential lenders or investors with an understanding whether a company is prepared to repay timely for its financial obligations.

There are two types of ratings: sovereign – the rating of a state and corporate – the rating of entrepreneurs reliability. The most important is sovereign rating, it is considered to be always more reliable than corporate one.

Today Ukraine's sovereign ratings are the following: according to the international rating agency Fitch Ratings – CCC, Standart & Poor's – CCC, Moody's – Caa2 (Bloomberg, 2014; FitchRatings, 2014; Reuters, 2014). These ratings are extremely poor assessments of Ukraine as a potential place for investments. The main reasons for Ukraine's sovereign ratings are the following:

- weak government institutions;
- corruption;
- shadow economy;
- weakness of gold reserves;
- trade deficit;
- growing national debt;
- dominance of political factors in economic decision-making;
- Ukraine's dependence on commodity markets;
- slow growth of GDP;
- high risks in different areas of management, risk of budget plan default;

- low level of industrialization;
- low trustworthiness to judiciary system.

Conclusions of international rating agencies play an important role, since a large number of potential investors make decisions based on these ratings. International rating agencies help investors assess the overall business environment (background). If there are low ratings of a country and unfavorable business environment, there is no financial interest for investors to provide funds the leading to lower creditworthiness and financial stability. And it is not only about money debt, but also direct investments inflow. Poor Ukraine's credit ratings hurt the economy as a whole.

However, not all areas of investment are so unreliable. Some positions have quite low risks, such as risks for portfolio investors. Stock markets are more trustworthy. Ukraine's Euro bond commitments were paid on time. But the property market situation is much worse. Here the leading role plays the weak judicial system, which significantly increases the potential risks for investors. Thus, in certain fields creditworthiness and financial stability due to low risks may increase (Prizma, 2014).

There is a "big three" most successful and best-known credit rating agencies in the world now: Moody's, Standart & Poor's and Fitch Ratings.

Fitch Ratings is an international corporation, known primarily as a rating agency. Its main purpose is to evaluate the world's credit markets and to provide independent analytical data for future credit ratings. It was founded in 1913 and is located in New York, USA (Prizma, 2014; FitchRatings, 2015).

Standard & Poor's (S&P) is a subsidiary of the McGraw-Hill corporation, that makes analytical overviews of financial markets. The company is known primarily as the creator and the editor of the American stock index "S&P 500", in 1860 in New York City, USA (Prizma, 2014; Standard & Poor's, 2015).

Moody's is the international rating agency. Its main goal is to assign credit ratings, provide research and risks analyses. The agency employs over 4,500 experts in 26 countries. The agency was founded in 1900 in Boston, USA (Prizma, 2014; Moody's, 2015).

These credit ratings are highly important, because investors may use them for different purposes, which in turn are useful for issuers. For many investors their ratings are an important element in determining securities value. Therefore, ratings are often used as criteria for the formulation of investment essentials.

Today, at global markets, rating is a "credit passport" that provides access to international investors. For markets, in which an issuer is unknown, or where investors are unfamiliar with the language and business culture or local financial reporting standards, the role of such a "credit passport" is hard to overestimate.

Analytical research used by rating agencies and ratings and reports they provide, help to maintain investors' confidence, especially under market volatility. For example, any news in media may affect negatively the price of bonds traded. The trust to international rating agencies and independent analysis help to restore investor's confidence in the securities of an issuer.

While assigning a credit rating for a certain company, the focus is made on the following major issues:

- corporate strategy and corporate philosophy is usually presented by of Chief Executive Officer or CFO;

- general information and the history of the group, which includes the company that plans to issue debentures and information about it;
- complete analysis of the related business risks including industry analysis, assessment of competitive positions, vulnerability under technological changes, legal environment, seasonal and cyclical changes;
- detailed analysis of financial risks:
 - 1) stability and predictability of cash flow;
 - 2) the price structure and the ability to increase efficiency;
 - 3) dynamics and profit forecast from main activities;
 - 4) the annual report analysis in terms of maturities and amounts of debt. This analysis is used to predict the financial status of the company for the next 3 years;
- management team in terms of its strategic vision for the future of the company and the ability to implement this strategy successfully.

According to the results of the analysis, international rating agencies carry out further research and discuss it regularly with a financial department. Usually the whole rating process takes about 90 days.

After the decision being taken a company issuer is informed about the rating it is assigned. If the company decides to publish it, the international rating agency sends a press release to major financial sources worldwide.

When making decision international rating agencies consider all relevant risk factors and take into account all points of view. When determining the rating specific risk factors that may vary depending on the industry are considered.

After assigning the rating, international rating agencies regularly check them to confirm they are at the same level or it is necessary to review the ratings (Standard & Poor's, 2015; Moody's, 2015).

Today, Moody's operates by 32 systems of ratings' definitions. Its number is growing every year. Currently, there are 4 main groups of ratings:

- General credit ratings.
- Special (branch) Structured Finance Ratings.
- Country's limits.
- Other non-credit rates.

Moody's ratings are assigned by Moody's Global Scale and represent the possibility that some financial commitments may not be fulfilled as expected and the probability of default and any financial loss in case of default.

To each general category rating (from Aa to Caa), Moody's adds digital modifiers: 1, 2 and 3. Modifiers indicate the present position of obligation, whether it is located at the top of its overall rating category, mid-range position or at the bottom (Moody's, 2015).

In the long-term rating scale Standard & Poor's assess the ability of an issuer to timely fulfill its debt obligations. Between the ratings AA and B there may be an intermediate evaluation, marked with plus or minus (for example, BBB+, BBB and BBB-) (Standard & Poor's, 2015). The scale is as follows (Table 1).

The main purpose of the analysis made by international rating agencies is to provide comprehensive information on all aspects of property investment to potential investors. Thus, political environment as an external economic factor plays a major role. Due to the deterioration of political environment and the overall economic sit-

uation (background) international rating agencies often have to review their credit ratings for some companies and adjust them to changing external conditions.

Table 1. The scale of credit ratings by international rating agencies, summarized by the author

Ratings			Meaning
Standard & Poor's	Fitch	Moody's	
AAA	AAA	Aaa	The highest level of financial stability. The lowest expectations of default. This rating level is assigned only to exceptionally high ability to repay financial obligations.
AA	AA	Aa	Very high financial stability. This category of rating indicates very low expectations of default risk. They show a very high ability to repay financial obligations.
A	A	A	High financial stability. This rating indicates low expectations of default risk. The ability to repay financial liabilities is estimated as high. However, this ability may be more susceptible to adverse business environment and adverse economic conditions than for higher ratings.
BBB	BBB	Baa	Good financial stability. Ratings indicate a low expectation of credit risk at the moment. The ability to repay financial liabilities assessed as adequate. However, the negative impact of business environment and adverse economic conditions with high probability can reduce this ability.
BB	BB	Ba	Speculative rating. Ratings indicate high susceptibility of credit risk, especially in the case of adverse changes in business environment or economic conditions over time.
B	B	B	To a high extent speculative. Indicate the presence of slight credit risk.
CCC	CCC	Caa	Indicate the presence of significant credit risk.
CC	CC	Ca	Very high level of credit risk.
C	C	C	Exceptionally high level of credit risk.
SD	-	-	Issuer refused to pay certain obligations.
D	-	-	A default was declared. Credit rating agencies believe that the issuer refuses to pay most or all obligations.
NR	-	-	No rating.

On February 12, 2014, Fitch downgraded the long-term foreign currency ratings of 12 Ukrainian companies following the declining in long-term rating of Ukraine under the obligations in foreign currency. Growing uncertainty about the political and economic situation in Ukraine could eventually have threatened the ability of some companies to fulfill their obligations in local and foreign currencies. In particular, Fitch decreased the long-term ratings of the following companies: "DTEK Holdings BV", "Ferrexpo Plc", "Lemtrans LLC", "Metinvest BV", "OJSC Myronivsky Hliboproduct" and others (Prizma, 2014).

On February 13, 2014, Fitch downgraded the long-term rating of the IPU Ukraine "UZ" in foreign currency from level "B-" to "CCC". And the long-term issuer default rating in national currency was confirmed at "B-" level. This decision is caused by a decrease in long-term rating of Ukraine in foreign currency. Ratings "UZ" are on the same level with sovereign ratings. Therefore, in case of Ukraine's rating

downgrade, the downgrade of "UZ" will come as well. Thus, the rated company is completely dependent on the sovereign rating of Ukraine (Zn, 2014).

On February 14, 2014 Fitch downgraded from level "B-" to "CCC" the Long-term Issuer Default rating in foreign currency of 13 Ukrainian banks, including "OschadBank", "PrivatBank", "Prominvestbank", "Credit Agricole Bank", "Alfa-Bank" and others. The rating revision was caused by a decrease in long-term rating of Ukraine in foreign currency and confirmation of long-term default of issuer in local currency to "B-" level with "negative" outlook. This rating reflects the increased risk of strengthening the control over capital and the introduction of currency restrictions. This can significantly limit or reduce the ability of private sector to make payments on liabilities in foreign currency (Finance Liga, 2014).

On February 21, 2014 Standard & Poor's downgraded the sovereign credit rating of Ukraine from CCC + to CCC, with "negative" forecast. The reason for this decrease in the long-term rating of Ukraine in foreign and local currencies, as S&P explains, is the sharp deterioration of political situation in the country and growing uncertainty about buyout of Ukrainian bonds by Russia. Prior to this on January 29, 2014, S&P lowered the long-term rating of Ukraine, which was due to defining Ukraine as a society that is undergoing internal problems of weak political structure and extremely rapid growth of economic and systemic risks (Top RBC, 2014).

On April 5, 2014 Moody's downgraded government bonds of Ukraine from "Saa2" to "Saa3". Moody's explains the downgrade by 3 factors exacerbating long-term economic, tax and budget problems of Ukraine. Among these factors: escalating political crisis and the deterioration of relations with Russia, are external liquidity situation in the light of the termination of financial support from Russia, higher gas prices and deteriorating macroeconomic indicators. At the same time Moody's downgraded Ukrainian state-owned enterprises "Financing infrastructure projects" from "Saa2" to "Saa3". The forecast is "negative" according to the prediction of the sovereign rating. The rating revision was caused by significant risk of suspension of IMF funding because of poor compliance of Ukraine in the past, and by conditions of a newer program (Economics puls kiev, 2014).

On February 20, 2015, Fitch downgraded 5 Ukrainian corporations ("Avangardco Investments Public Limited", "Ukrlandfarming PLC", "NJSC Naftogaz of Ukraine", "Lemtrans LLC", "DTEK Energy B.V.") on sovereign action. That was done following the agency's rating action on Ukrainian sovereign rating. These corporate ratings reflect high concerns about the deterioration of the liquidity position of Ukrainian corporates in the face of weakening sovereign credit profile and local economic problems, which may threaten the companies' ability to meet both their foreign and local currency obligations. It was also noted that Fitch believes that corporates with a CCC foreign currency IDR may be able to survive the shock of any sovereign debt crisis (FitchRatings, 2015).

Although there are numerous situations when actual market events were in sharp contrast with the assessed ratings. In 2001, Standard & Poor's downgraded the rating of energy corporation "Enron" from "investment" to "junk" level. It was done only a few days before its bankruptcy. In 1996, Moody's has assigned the maximum investment rating to South Korea. The country became one of the first victims of the massive financial crisis, thus bringing huge losses to investors (Bekasov, 2012).

In September 2008, one of the biggest international investment banks "Lehman Brothers" went bankrupt. This bank had high ratings (higher than "A") from all 3 leading rating agencies. The "Big Three" refused to be responsible for the assigned ratings on the bonds of "Lehman Brothers". They stated that they cannot take the responsibility for decisions made by investors and didn't push them to purchase securities (Bloomberg, 2009).

Conclusions. Both external and internal factors affect the activity of any entity. One of external economic factors is political environment. During the unfavorable political situation the failure of the budget plan, the fall in industry, reduction of foreign reserves inevitably lead to a reduction of probability of timely repayment. By setting credit ratings international credit rating agencies play an important role in the formation of credit and financial stability of both enterprises and nations as a whole. Any enterprise is affected by external environment due to the fact that an isolated existence of any enterprise is not possible.

In turn, low credit ratings set a barrier between the issuer and potential investors, since such a rating is the result of a careful study of all areas of the issuer and reflects its real investment attractiveness. But investors are not recommended to be guided only by ratings assigned by credit rating agencies, because there are situations, when incorrect ratings caused big financial losses. Although trust to international rating agencies was undermined, the ratings remain to be important instruments for investors use. Thus, financial stability of any enterprise is extremely dependent on such an external economic factor as political environment.

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