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MANAGING THE FINANCIAL FLOWS: GLOBALIZATION ASPECT

***Abstract**: the basic trends in financial flows movement on the regional level have being examined in context of integration and globalization processes. The influence of financial flows on the financial potential of the region and its ability to develop own financial infrastructure have being analyzed. The directions for overcoming the negative influence of the institutional factors on the financial flows movement have being defined.*

***Keywords**: financial flow, region, financial potential, institutional factors, globalization, financial infrastructure, economic growth.*

Introduction

Recent trends of the global economy testify the undoubted connections between economic growth and financial development. According to the World Development report 2002 [13, p. 96] financial development leads to economic growth, poverty overcoming and social stability. But financial development is not just a result of innovations in different fields. Financial development, exactly, is the basis for creating and implementing the innovations, enforcing the industrial progress, searching for new managerial techniques and methods. This position is strongly supported by John G. Gurley and E. S. Shaw [10, p. 515] and R. Levine [11]. In these researches the importance of development of financial instruments, financial institutions and intermediaries for successful development of other sectors of economy is underlined.

There are a lot of unsolved problems in the financial sector in Ukraine. But it's difficult to be disagreeing with the noted authors, because poor development of the financial sector, especially of financial institutions and intermediaries, is one of the main causes of lack of financial resources for innovative development of the industry and insufficient development of the regional infrastructure.

Another problem of providing the economic growth in Ukraine is the misbalances in regional development. This aspect is crucial in terms of increasing the financial independence of the regions, processes of European integration and globalization. In this case it is necessary to asses the financial potential of the region and define the contribution of the region into development of the whole country.

A lot of researches are dedicated to analysis of the quality and development level of the financial infrastructure [1, 8, 12], assessment the capital and investment [7], motivation the financial basis of economic development [3, 9, 11]. But there are number of weaknesses in these researches. First, foreign researches are mostly oriented on the highly developed financial markets on which number of participants and regulators acts not for years but for centuries. Second, highly developed financial markets are much more transparent for all participants, so researchers have an access to the significant database. Third, the market transparency makes it easy to overcome the problems with collecting the information about contractors, financial institutions and intermediaries that leads to reducing the information costs. Thus, foreign researches are poorly adapted to peculiarities of undeveloped financial markets and it leads to number of errors in strategy and tactics of all market participants.

Considering the researches made for undeveloped financial markets, it's necessary to mention the following weaknesses:

(i) the biggest part of researches is based on the classical and neoclassical economic and financial theory and doesn't involve the institutional peculiarities of undeveloped financial market [1, 7, 8, 11, 12];

(ii) researches that discover the economic foundations for creating an effective financial market mostly include the static elements and suffer from lack of dynamics [12];

(iii) financial flows of real sector of economics are usually considered just as a "sub-product" of operational, investment or financial activity of an enterprise, but not as and adequate indicator of economic activity of all market participants on different levels of economy [8].

Moreover, the financial flows of real sector of economics of industry-oriented countries are the indicators of ability of different country's regions to create own infrastructure including the financial.

Thus, the goals of the presented article is to discover the basic trends in financial flows movement on the regional level in context of integration processes, to assess the influence of these flows on the financial potential of the region and its ability to develop own financial infrastructure.

1. Basic trends in regional financial flows movement in Ukraine

Financial and economic crises of 2008-2009 hardly knocked the Ukrainian industrial enterprises, especially in metallurgy and mining. But significant decrease in output and returns was caused not only by global tendencies and misbalances on the international markets. One of the principle causes of this situation is lack of internal motivation to create an effective and competitive production, to accumulate significant financial resources in order to invest them into innovative development of enterprises. During all years of independence in Ukraine there was a strong trend of flight of capital by the major financial-industrial groups. The statistical data proved these trends (tabl. 1) [5, 6].

Table 1

Regional structure of foreign direct investments, %

Regions	2004		2008	
	FDI outflow	FDI inflow	FDI outflow	FDI inflow
Off-shore zone	16,0%	17,4%	94,5%	25,2%
Zone of favorable investing	6,7%	42,0%	0,5%	28,2%
Russia	53,0%	5,7%	1,6%	5,2%
Other countries	24,2%	34,9%	3,4%	41,4%

Source: calculated on the data of the State Committee of Statistics [14]

The process of flight of capital has a negative influence not only on particular enterprise, but on the financial potential of the region and country as a whole. Moreover the system character of such trend may lead to collapse of the regional and country financial system [3]. Assessing the influence of enterprises activity and their financial flow on development of the financial potential of the country and its regions let's discover the main components of the aggregated financial flow generated by the enterprises. In this research we divided all regions of Ukraine into five groups: Central region (Kyiv, Zhitomir, Kirovograd, Cherkassy, Chernigov); Prydniprovsk-Donetsk region (Dnepropetrovsk, Donetsk, Zaporizhzhya, Lugansk); North-Eastern region (Sumy, Kharkov, Poltava); Black Sea region (Odessa, Kherson, Mykolaiv, Crimea); Western region (Lvov, Lutsk, Rivne, Ivano-Frankovsk, Chernovtsy, Zakarpattia, Khmelnitsky, Ternopol', Vinnitsa).

According to this distribution we have analyzed the financial inflows and outflows generated by enterprises in each region and assess the influence of these financial flows on the financial potential of the country.

Table 2 shows the contribution of enterprises of the region in total operating financial flows. As it shown two of five regions (Central and Prydniprovsk-Donetsk) provide 78.9 % of total operating inflows.

Table 2

Operating financial flows of enterprises in 2008, by regions)

Region	Total operating financial flow, $ mln.		Contribution in total		Operating financial flow per capita			
					total, $		+/- to average, %	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
Central region	28 219	22 973	**0,414**	**0,374**	3 054	2 486	106,6	87,0
Prydniprovsk-Donetsk region	25 588	23 082	**0,375**	**0,376**	2 127	1 919	43,9	44,3
North-Eastern region	3 252	3 602	0,048	0,059	594	658	-59,8	-50,5
Black Sea region	5 003	5 149	0,073	0,084	711	732	-51,9	-45,0
Western region	6 146	6 547	0,090	0,107	497	530	-66,4	-60,2
Total	**68 209**	**61 353**	1,000	1,000	1 478	1 330	-	-

Source: calculated on the data of the State Committee of Statistics [14]

The principle factors that cause such differences in distribution of operating financial flows of enterprises are the following. Central region includes Kyiv in which biggest industrial corporations have a head-quarter. Exactly in Kiev biggest part of large trade and investment contracts is made. Also biggest industrial enterprises that provide over 50% of all industrial output are located in the Prydniprovsk-Donetsk region. But analysis of FDI has shown the misbalances in financial inflows and outflows in the Prydniprovsk-Donetsk region. In spite of creation of 37.5% of operating financial inflow and 37.6% of outflow the international investment activity of this region is not just poor, but directed on the flight of capital (tabl. 3).

Analysis of investment and financial activity of several industrial enterprises of this region that are owned by biggest industrial-financial groups of Ukraine gives us a possibility to confirm the existence of the trends of goal-directed flight of capital.

Table 3

Foreign direct investments in 2008, by regions ($ mln.)

Region	FDI total		Δ FDI total	Year FDI		Year Δ FDI
	inflow	outflow		inflow	outflow	
Central region	15138,6	235,4	14903,2	3883,8	46,7	3837,1
Prydniprovsk-Donetsk region	5347,8	5439,3	-91,5	0,0	17,3	-17,3
North-Eastern region	4097,1	15,4	4081,7	2324,2	0,0	2324,2
Black Sea region	2094,1	38,0	2056,1	46,9	1,6	45,3
Western region	2845,5	1,0	2844,5	334,2	0,1	334,1
Total	**29523,1**	**5729,1**	**23794,0**	**6589,1**	**65,7**	**6523,4**

Source: calculated on the data of the State Committee of Statistics [14]

Taking into consideration the regional attribute of the industrial-financial groups, over 97.4% of FDI outflows are generated by these groups in order to move the return and dividends into more favorable economic climate – to off-shore zones.

The market distribution of the financial inflows and outflows of the enterprises (tabl. 4) illustrates the poor development of the financial infrastructure both on the state and on the regional level. Only 6.0% of total inflow is generated on the capital market and 32.0% - on the financial market. The worse situation with financial outflows – only 4.4% of total financial outflow is allocated on the financial market, 0.06% in average goes to investments.

Table 4

Market distribution of financial flows by regions

Region	Financial inflow			Financial outflow		
	Goods and services	Financial market	Capital market	Goods and services	Financial market	Capital market
Central region	53,0%	39,7%	7,3%	92,4%	7,5%	0,11%
Prydniprovsk-Donetsk region	77,5%	22,5%	0,0%	97,7%	2,2%	0,05%
North-Eastern region	44,0%	24,6%	31,4%	96,6%	3,4%	0,00%
Black Sea region	68,2%	31,2%	0,6%	96,5%	3,5%	0,01%
Western region	67,8%	28,5%	3,7%	97,8%	2,2%	0,00%
Average	**62,0%**	**32,0%**	**6,0%**	**95,5%**	**4,4%**	**0,06%**

Source: calculated on the data of the State Committee of Statistics [14] and National Bank of Ukraine [15]

The undeveloped financial and capital markets enforce entrepreneurs to look for additional sources of finance including the hidden sector of economy. In these conditions the government activity on all levels of economy should be directed from the one hand on facilitating the access to low-cost financial resources (including the funds of international financial institutions and foreign investors) and from the other – on motivation and stimulation for accumulating the financial potential in the region.

2. Financial potential vs. financial flows in context of economic growth

Economic growth and financial development are closely bounded. Financial development involves several essential points: improvement in quality of information about financial opportunities, development of monitoring system and corporate governance, optimization of the risk-management process and its tools, increase in accumulation of the capital (savings, earnings, etc.) [11].

Mechanism of economic growth is complex. It is characterized by presence of number of necessary elements, interrelations and relationships. But it is an undoubted fact that the financial background is the defining issue of further development. Thus, the creation of this financial background is crucial. Let's consider the process of creation of the financial background of economic growth.

In this context we will differ the following terms: financial potential, financial infrastructure and financial flows. What is the principle differ between financial potential and financial flows?

Financial potential instead of financial flow is the static category, which characterizes the ability of person, company, region or country to accumulate and allocate the financial resources. Financial flow discovers the dynamic characteristics of action corresponded to accumulation and allocation the financial resources. Financial potential may become a "deadwood" without realization i.e. without creation the corresponding financial flows. But in this case the principle conflict may arise: to create the financial flow means to decrease (for a while) the financial potential (fig. 1).

If the managerial decision was right, the financial outflow, which leads to decreasing in financial potential, will provide surplus financial inflow and by this – increasing in the future financial potential. But what will be happened if the decision was wrong?

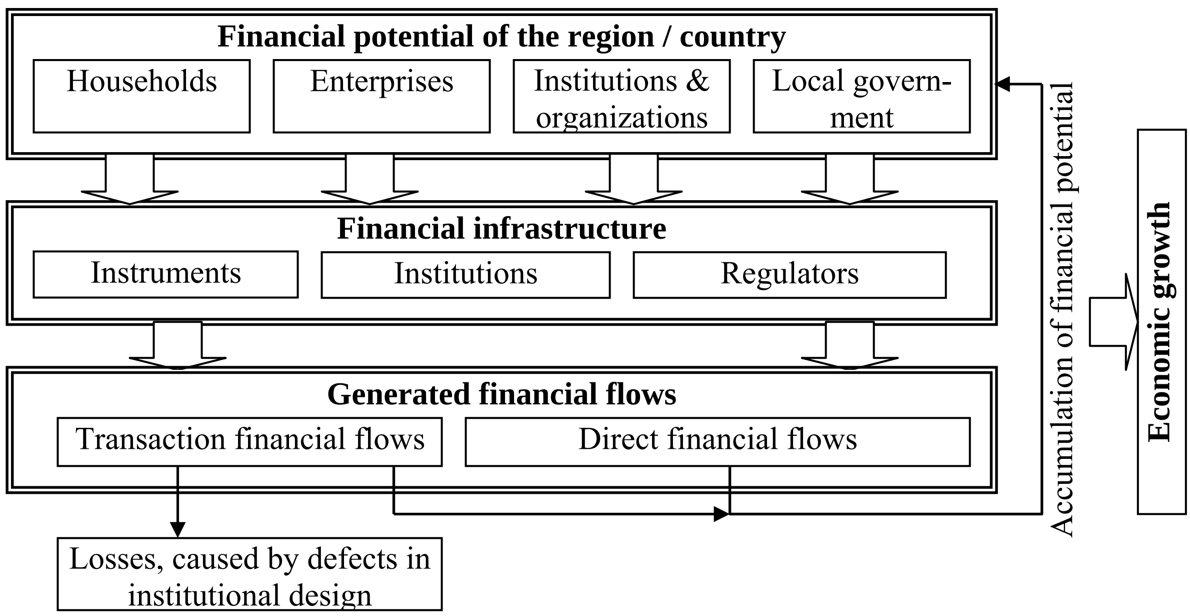

Fig. 1. Financial potential, financial infrastructure and financial flows

The reliability of the decision-making process depends on complex of internal and external factors, which among others includes level of development of financial infrastructure and complex of institutional factors (including the informational provision of the process). Significant attention in this case should be paid to transaction financial flows that are the dynamic reflection of the transaction costs. Thus, in process of managing the financial flows and improving the financial potential of the region (or country) it is necessary to take into consideration not only the direct financial flows generated by contractors, but also transaction financial flows caused by the following:

(i) time spent for conducting the particular operations including the process of searching and analyzing information and time for decision-making;

(ii) probability of opportunistic behavior of the contractors;

(iii) defects of institutional design (including the insufficient development of financial instruments, institutions and regulators).

As it was mentioned earlier the economic growth is practically impossible without proper development of the financial system and financial infrastructure, active participation in the financial circulation of financial intermediaries [10, p. 519]. The development of financial intermediaries exactly discovers new opportunities for economic subjects to allocate their financial resources effectively i.e. to realize and to improve their financial potential in future.

In Ukraine the level of development of financial intermediaries is insufficient. 22.5% of working capital of industry can be covered by the loans issued by commercial banks of Ukraine (fig. 3).

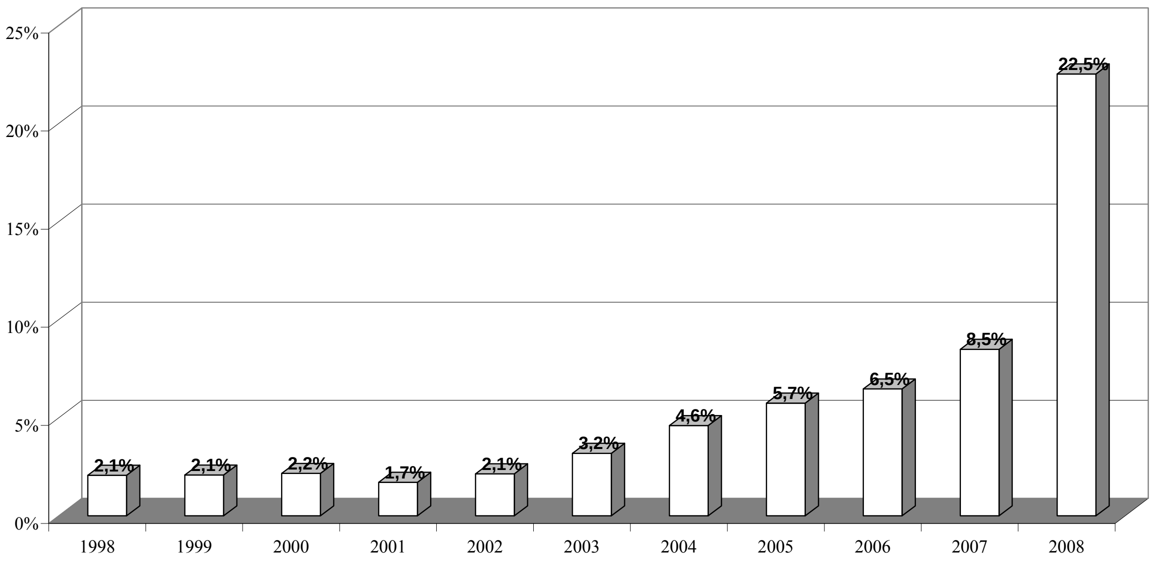

Fig. 3. Credits issued by commercial banks to industrial working capital, %

Source: calculated on the data of the State Committee of Statistics [14] and the National Bank of Ukraine [15]

But the increase of share in 2008 was achieved not only due to activation of financial market (increase in loans – +48.9%), but also due to significant decrease in the industrial working capital – -78.1%. Financial institutions in Ukraine obtain only 1.5% of all economic subjects; the level of operations of insurance system is only 5.2% of GDP (instead of Euro area – 24.7%). In such conditions it is vitally necessary to create the proper strategic program for developing the financial infrastructure.

3. Institutional aspects of financial development in terms of globalization

Today reality and crises trends in the global economy discover a lot of reefs that create additional barriers for sustained economic growth and financial stability. Most of them are caused by a "human factor" that is reflected in individualization of needs and preferences, subjectivism in decision making, conflicts in interests of different groups of contractors and participants of the global market. In this case the exception of the institutional factors from economic models, decisions and researches is mistaken at least. Especially it concerns the poorly developed economy. As it was mentioned in the WDR 2002 [13, p. 76], in developing countries the institutional factors (local reputation, group norms, etc.) play a very important role in the process of distribution of financial resources. And this role is not only positive. Individual interests in such countries are more valuable than accessing the goals of enterprises, introducing the innovations, reaching for the social, economic or ecological effect [2, 3].

In this case the question of motivation and stimulation of business owners to innovative and sustainable development is the crucial issue of the government policy. In other case, as V. Dementiev said [3], there would be a great probability of deformation of priorities and preferences of the contractors that can lead to opportunistic behavior of the market participants. Basic trends, defined earlier, are proving this thesis. Biggest part of the generated financial flows goes to consumption, dividends to off-shore companies and their owners instead of investments and innovative development of enterprises. But over-rated role of individual interests and preferences is caused not only by direct economic and social factors, but also by defects of the institutional construction of the economic system.

Globalization has contributed some peculiarities in the institutional construction of the Ukrainian economy:

- increasing role of foreign financial institutions, which can provide the low-cost financial resources to the Ukrainian enterprises;
- increasing role of international (IMF, World Bank, WTO) and European regulators and institutions, which can provide the low-cost financial resources to the Ukrainian government in exchange for conducting the structural reforms and realization of "Action Plan";
- reliefs in accessing the international market for large financial-industrial groups that leads to redistribution of the capital allocation and provide the additional opportunities for increasing the business profitability (including the opportunity to use the advantages of off-shore zone);

- hardening the competition on the domestic market of the background of entering the WTO and limitation of the protective activity of the government.

Listed peculiarities require their including into the methodology of the financial decision-making and managing the financial flows not only on micro-level but also on regional and macro level. Thus, local and state government should take into consideration the following aspects [4]:

(i) institutional incompleteness that provides the certain degree of liberty and possibility of opportunistic behavior of contractors;

(ii) the number of constitutional (private property, free of contracts, responsibility) and operational (general, specific and hidden) rules which creates the institutional frames;

(iii) imperfection of information: information is mostly pay, limited and can be differed by the level of reliability. All these factors cause the limited rationality of the managerial decisions on each level of the economy.

That's why the managerial process should take into consideration both internal and external factors, that have an influence on the financial flows on each level of economy and stage of GDP creation and distribution (fig. 2).

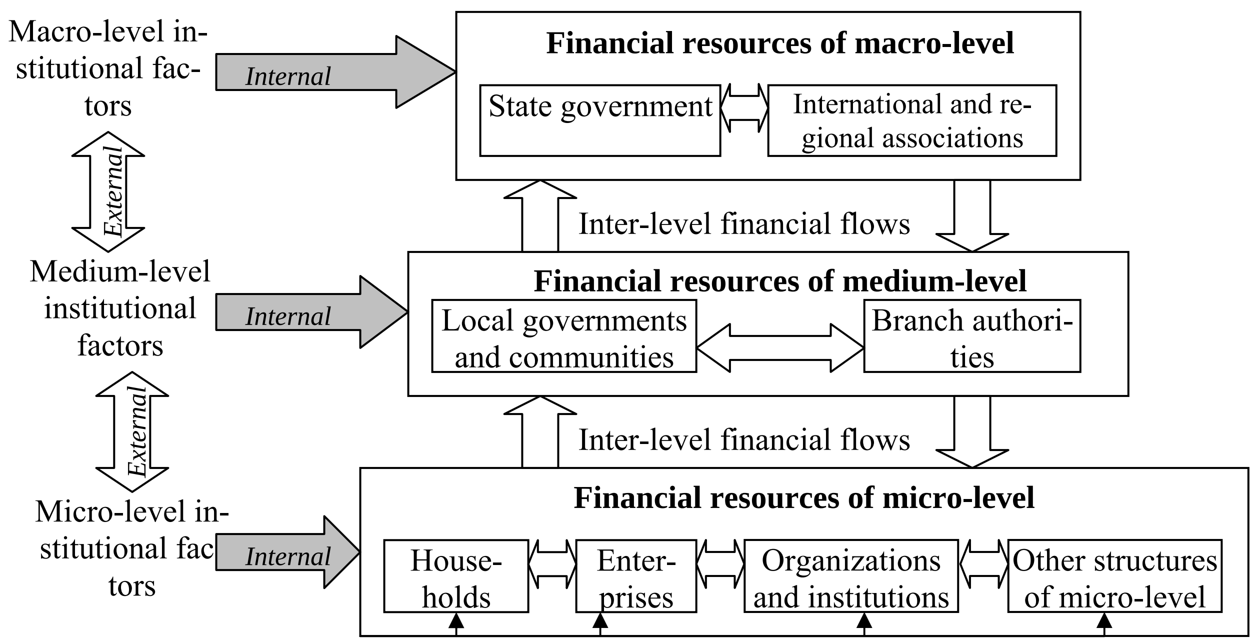

Fig. 2. Financial resources and financial flows by levels of economy and influence of the institutional factors

As it shown, there are a lot of institutional factors both internal and external on each level. The conductors of consequences of influence of internal and external factors are intra-level and inter-level financial flows. So, the financial flows are the reflection of the institutional peculiarities of the intra-level construction that reflects in the defects of inter-level communications and misbalances. Thus, the crucial issue, which should be taking under the government control, is the structural changes in the intra- and inter-level financial flows. This will give the opportunity to define to most problematic areas for government interference and corrections in the institutional structure for sustaining the further economic growth of the country.

Conclusion

Investigation of process of managing the financial flows of regions in conditions of globalization lets us to define the following:

1) Tight correlation between economic growth and financial development brings on the first row problems of accumulation of the financial potential of the regions and stimulation of improvements in their financial infrastructure.

2) Globalization process in terms of developing countries and undeveloped financial market leads to appearance of strong motivation of relocation of capital in more attractive branches and regions and as a result to flight of capital to off-shore zones.

3) Defects of institutional design, which are deepen by institutional incompleteness, unclear institutional frames and imperfection of information, require taking into account intra-level and inter-level transaction costs and corresponded transaction financial flows.

4) Regional and state policy in context of poorly developed financial infrastructure requires the implementation of system approach in solving this problem that should includes:

- stimulation for accumulating the financial potential on the micro-, medium- and macro- levels by introducing the monitoring system, which will examine the structural changes in the intra- and inter-level financial flows;

- facilitation of the barriers for the international and foreign financial intermediaries, which can provide the low-cost financing for the real sector of the economy;

- creation of regional and state programs for goal-directed development of the financial structure that will be directed on the motivation of the financial institutions to master new financial instruments;

- improvement of the legislation in terms of relations with off-shore zones and juridical persons, registered in these zones but owning the domestic enterprises.

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