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Self-Financing in Market Developed Countries: Formation and Development

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Abstract

The article deals with the main elements of a market economy, such as self-sufficiency and self-financing. The paper notes that the highest level and dynamics of self-financing are achieve in the conditions of innovative development of corporations or enterprises. In addition, through an excursion into the history of the formation and development of self-financing, a number of proposals are made on the need to maintain this phenomenon in the context of the transition to a market within countries with economies in transition. This makes it possible to increase the stability for the economic mechanism of enterprises

Keywords: *self-sufficiency, self-financing, mechanism, private prop*

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1. Introduction

One of the main elements of a market economy is the transition of enterprises to the principles of self-sufficiency and self-financing. Three centres - the USA, Western Europe and Japan - have accumulated vast experience in organizing self-financing of enterprises and corporations. In market conditions, this is not a frozen, but a dynamic process that develops under the influence of the cyclical nature of reproduction, various market fluctuations, the international division of labour, and scientific and technological progress. Self-financing reaches the highest level and dynamics in the conditions of innovative development of the economy.

The general classical, established form of self-financing is the enterprises own savings in the form of retained earnings and depreciation, which are supplemented by a rational share of the issue of securities and loans received from the loan capital market. It did not take shape immediately, but gradually, along with the main stages in the development of market relations. [Alieva, S. S. (2019), Алиева, С.С. (2011)].

Self-financing develops with the attraction of a loan and with a certain participation of the state, which encourages this policy. In market conditions, it expands its scope through the capitalization of added value and through the issuance of securities. At the same time, financial assistance from the state is episodic in nature and is due to extraordinary circumstances. In developed countries, self-financing can be characterized by the highest level with deeper and wider state intervention in the economy.

Theoretical basis of self-financing in a market economy. The financial and economic crisis of 2008 showed that the current self-financing mechanism, adopted back in the period of free competition, and also based mainly on weak market demand and equity financing in the conditions of exchange speculation, cannot function effectively and needs to be radically reorganized. However, the private sector itself cannot solve this problem, since the contradictions of private property interests are too great. Therefore, a new economic mechanism is needed that can bring the economy out of the crisis and ease social contradictions. It must solve not only macroeconomic, but also microeconomic problems, i.e. to update the economic mechanism of the enterprise itself.

Literature review. Such a renewal mechanism was state-monopoly regulation, based mainly on the Keynesian doctrine and the subsequent concepts that grew out of it. This is evidenced by various areas of neo-Keynesian theories that became widespread in the leading market developed countries in the 50-60s of the last century, especially in the USA, England, Germany, France.

Theories of Keynesian and neo-Keynesian regulation were mainly macroeconomic in nature, but they also had a direct impact on the microeconomic level through a set of state tools such as government orders and entrepreneurship, monetary regulation and fiscal impact on the economy. [Zarif, A. (2022).]. Each of these elements influenced the economic mechanism of the enterprise and thus the self-financing system.

Keynesian regulation of the economy made it possible to generally strengthen the economic mechanism and method of self-financing of private enterprises, but the increased rate of government regulation on stimulating public spending led to an increase in budget deficits and public debt. The latter sharply increased the costs of private enterprises for raw materials, materials and equipment, which significantly narrowed the scope of profit accumulation. In addition, inflation has created various disproportions in the economy.

Therefore, in the late 1970s and early 1980s, in the developed market countries, almost everywhere, a partial departure from these methods of economic regulation began. Two concepts are being greatly developed: the theory of supply-side economics and the theory of monetarism, which are adopted by the ruling circles. The essence of the new concepts boils down mainly to a major reduction in taxes and government spending, which should be combined with the manipulation of the money supply and interest rate policy in order to reduce inflation. This allows, in the microeconomic aspect, to increase the stability of the functioning of the economic mechanism of a private enterprise, increase its cash savings and raise the level of self-financing.

In connection with the strengthening of the trend towards self-financing of corporations within the framework of neo-Keynesianism, special theories of accumulation arose (back in the 50-60s), expressing an assessment of self-financing in the reproduction process, and which became most widespread among American economists. These theories reflected, in essence, two opposing views on self-financing. Such prominent American economists as A. Burley and R. Minz, for example, sought to prove the independence of commercial and industrial corporations from credit and financial institutions and the loan capital market in connection with the growth of self-financing. Moreover, the evidence was cited mainly on artificially selected statistical data on the process of financing corporations. In their views, in essence, the idea was to stop the merging of industrial and banking capital in such an important area as long-term financial ties.

Another, more numerous group of economists: S. Kuznets, D. Krimer, S. Dobrovolsky, I. Borenstein, A. Koch, P. Boren, P. Sweezy, D. Galbraith, W. Goldsmith and a number of others (Daniel Creamer & Sergei Dobrovolsky & Israel Borenstein, (1960), Koch A.R. (1943), Kuznets S. (1961), Baran P.A., Sweezy P.M. (1966)] showed that self-financing does not mean complete independence from financial institutions and the capital market, based on a deep statistical analysis of self-financing trends in the 1950s and 1960s, they showed that the dependence of corporations on the capital market did not decrease, but, on the contrary, increased.

The further development of the economy further strengthened and expanded the provision on credit, its role in the processes of centralization, represented by the banking system, a supplier of external sources of financing for private and state enterprises. This is confirmed by the whole practice of the capital accumulation process.

Analysis and results. *The concept and basic principles of self-financing*. The term “self-financing” is separated from the term reflecting the concept of financing industry and enterprise, which is widely developed in the analysis and characterization of the financing of the entire reproduction process, both at the macroeconomic and microeconomic levels. Back in the 1950s and 1960s, the emergence of a new term reflected the path of a new process, expressed in an increase in the share of internal sources (profit and depreciation) in financing enterprises and a decrease in the issue of securities and bank lending. Financing from 60 to 90% of capital investments, renewal of fixed capital, total current costs from domestic sources of accumulation was considered a high level of self-financing in industrialized countries. At the same time, entrepreneurs can potentially overcome financial difficulties through the accumulation of internal funds, and that, therefore, such self-financing can compensate for the misallocation of capital [Gentry, William M., and R. Glenn Hubbard (2004), Buera, Francisco J., Joseph P. Kaboski, and Yongseok Shin. (2011), Samphantharak, Krislert, and Robert M. Townsend. (2009)].

Features of the origin and practice of self-financing. In the self-financing of corporations under the influence of such factors as socio-economic development, market fluctuations, structural changes, innovative development, there have been certain changes. One aspect of the development of self-financing was the large cash savings of corporations in the US, Canada, and England. This led to the financing of current and capital expenditures of corporations to a large extent at the expense of their own sources of accumulation (Table 1).

Table 1 - Main sources of capital investment financing for leading countries

(% of gross capital investment)

	Self-financed			Public funds			Loan capital market (issue of securities and credit)			Total		
	1950	1956	1959	1950	1956	1959	1950	1956	1959	1950	1956	1959
USA	55,0	51,3	55,9	27,7	22,0	15,9	17,3	26,7	28,3	100	100	100
England	69,1	71,0	74,1	30,9	6,8	10,7	-	22,2	15,2	100	100	100
France	82,0	66,5	61,3	17,0	13,0	22,2	1,0	20,5	16,5	100	100	100
Germany	67,0	58,1	53,5	15,4	29,0	25,7	17,6	12,9	20,8	100	100	100

As follows from the table above, over 50-60% of gross capital investments were financed from own funds (that is profits and depreciation). At the same time, corporations constantly turned to the loan capital market, borrowing from 20 to 30% of total financing. A certain limitation of their own funds, as well as emission and credit sources, forced them to also use public funds in the form of loans and direct budget financing.

However, the ratio between internal and attracted sources from the loan capital market is determined by the movement of the market cycle, which was especially pronounced in the 1950s and 1960s. XX century. Thus, in the conditions of economic recovery, the share of self-financing objectively decreased, and the share of funds from the loan capital market increased, since the process of updating fixed capital and expanding production capacities require the attraction of additional large funds. In a depressed state of the economy, on the contrary, the share of emission and credit sources decreases, and the share of self-financing increases, as there is a slowdown or decrease in production rates, the sale of the mass of commodities on the market is difficult or is carried out passively due to falling demand and increasing unemployment. As a rule, in the post-war period in developed countries, the ratio between internal sources and attracted in the conditions of growth traditionally amounted to 70% to 30%, and during the recession, the share of self-financing increased sharply to 70-90% of corporate financing costs.

A more important feature of self-financing was that the traditional relationship between self-financing and attracted sources, due to the movement of the cycle, was significantly violated or undermined due to non-standard market changes in the 70-80s of the last century. In the 1970s and 1980s, when the depressed state of the economy was accompanied by all-scale inflation, there was a sharp decrease in self-financing and an increase in funds raised in the form of loans and the issuance of securities. During this period of the 20th century, contradictions sharply aggravated as a result of a decline in production, a decrease in the growth rate of capital investments, sectoral structural crises, the development of a fuel and energy crisis, and rapid inflationary processes (annual price increases in a number of countries amounted to double digits).

All this led to low liquidity and solvency, and in some cases bankruptcy of corporations. Under these conditions, profits and depreciation began to noticeably decrease due to inflation and high fuel costs, high interest rates. Low solvency forced corporate-type enterprises to sharply reduce the level of self-financing and increase capital borrowing both in the national and international loan capital markets. This trend was especially pronounced in the United States, where the overall level of self-financing of corporations fell to 20-30%. In some years during the mentioned period, the share of loans and equity securities reached 70-80% of financing of private US corporations.

In the US, the level of self-financing varies significantly across industries. The highest share is in the manufacturing industry (machine building, electrical, chemical, electronic, instrument making). In the extractive industries, utilities, transport, communications, the level of self-financing, on the contrary, was significantly lower, which is explained by a number of objective factors. The specifics of the extractive industries, for example, due to their capital intensity, require large capital expenditures, which forces corporations to significantly increase the level of issuance of securities and loans. In another case, the so-called service industries are more likely to experience a chronic crisis due to low competitiveness, weak demand, and falling prices, and therefore have a low level of self-financing and a high share of attracted emission-credit and government resources.

Conclusion. The development of market-developed countries has shown that the level of self-financing varies by country. During this period, taking into account the cyclical fluctuations in the market situation, the growth of self-financing and its high level was noted mainly in the USA, Canada, and Germany. In France, England, and small countries of Europe, the level of self-financing was lower, since here, until recently, the system of state and mixed enterprises was more developed. As a rule, in these countries the process of self-financing was combined with a wider attraction of credit and budgetary funds.

Among these countries, Japan stands apart, where, regardless of market fluctuations, until recently (somewhere until the mid-1980s), on the contrary, credit sources dominated in financing corporations, and the share of own money capital was low. This is explained, first of all, by a number of objective circumstances and the policy of the Japanese monopolies and the state. The development of Japan was characterized by a rather high rate of monetary savings, which led to their significant accumulation in the loan capital market. The foreign economic desire to conquer markets and outperform its competitors led to extensive borrowing in the loan capital market, which was fully encouraged by the state both through direct lending and through the development of preferential conditions for obtaining a private loan. It was only after securing significant monetary accumulations through foreign economic activity in the mid-1980s that Japanese corporations began to rebuild their own financing system. betting more on self-financing of their costs, and not on the loan capital market.

There was a dynamic change in the ratio between profit and depreciation in the framework of the implementation of self-financing. Of these sources, profit has been the most stable. As a rule, in an unfavourable market environment, there was a decline in profits and its ability to finance the current and capital expenditures of corporations sharply decreased. In addition, it was taxed and its accumulation depended on its size. Therefore, in the event of a decrease in the amount of profit as a result of the action of certain factors, the compensatory function was performed by depreciation deductions - a more stable source of financing. Depreciation was generally tax-free and not subject to cyclical fluctuations. However, in general, its volume depended on the equipment write-off policy pursued by the corporation itself and the state. Accelerated write-offs have enabled corporations to accumulate significant amounts of depreciation and ensure a high level of self-financing.

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