THE STAGES OF ESTABLISHMENT AND DEVELOPMENT OF FINANCIAL MANAGEMENT

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Abstract:
The paper reviews major stages of establishment and development of financial management, main conceptual theories, and methods, approaches, developed by academic economists in the field of corporate finance that became the basis for the development of financial management as a science. In the paper, the authors identify the major five stages of its establishment, in the process of which the range of thoroughly studied issues was constantly expanded, the methodologies of their research were enriched. The paper describes the main scientific works of famous economists of the relevant periods that have made a significant contribution to the formation and development of financial management as a science. The authors drew the conclusions about prerequisites to the development of financial science and research priorities in the financial management of enterprises.

Key words: financial management, financial resources, enterprises, corporate finance, securities, financial intermediaries, financial markets.

JEL classification: G30

1. INTRODUCTION

Financial management as a separate science originated in the developed countries at the turn of the 19th and 20th centuries with the development of financial and commodity markets and with the emergence of the need for a more detailed justification of financial transactions by economic calculations. As an independent branch of science on the financial administration of an economic entity, the financial management was formed at the junction of three important scientific areas: general management theory, classical theory of finance and accounting. Specifically, by virtue of the development of entrepreneurship, the emergence of corporate ownership, the institutions of financial intermediaries, the development of financial markets and the intensification of integration and globalization processes around the world, a specialized branch of knowledge has been established and called ‘Financial Management’. For better insight into the significance of financial management in the development of national economies, the importance of applying the basic conceptual and methodological foundations and theories, it is relevant to study the evolution of the establishment and development of financial management as a science.

2. ANALYSIS OF THE LATTER RESEARCH AND PUBLICATION

In foreign literature on corporate finance, the issues of the development of basic conceptual foundations of financial management have been the subject of researchers and experts, namely: J. Williams, J. Richard Hicks, H. Markowitz, F. Modigliani, M. Miller, M. Gordon, W. Sharpe, G. Donaldson, S. Myers, M. Scholes et al. The theoretical, methodological and practical issues in the post-Soviet space are covered in the works of such renowned academic scientists as I. Blank, A. Vasilik, V. Kovalev, A. Podpayogin, V. Savchuk, A. Stoyanova, V. Sutormina, A. Tereshchenko, V. Sheludko et al. They contributed to the development of financial management as a science, however, the modern financial theory and practice confirm that the problems of analysis and systematization of approaches to the major stages of the establishment and development of financial management, and study if the basic theories of its development are relevant.

3. STATEMENT OF BASIC MATERIAL

The history of the development of finance went back more than for a century. Generally, the financial science has arisen in practice. Hundreds of years, the countries tried to solve various financial problems. The issue of finance can be found in the thoughts of such famous scientists as Xenophon and Aristotle. Therefore, Xenophon proposed to use leasing of state property and captives, as well as duties and fees as sources of government receipts. The trade operations, supported by local banks, were the main source of revenues of the Rhodes state during the development of the islands of Greece in the 4th century. In the Middle Ages, general considerations arose regarding financial morality, found in various theological, philosophical, political and legal works of the scholastics [1].

In general, the financiers (financial managers) early enough took a leading role in the government. It can be explained by the fact that their activity was associated largely with fiscal function and search for various sources of revenue for the state budget. However, the basic theories of financial management of enterprises became the subject of scientific research much later.

For more than a hundred years of its existence, the financial management has passed a number of stages, in the process of which the range of thoroughly studied issues was constantly expanded, the methodologies of their research were enriched. Depending on the subject and basic financial management priorities, several stages of the establishment and development of financial management can be distinguished (Table 1).

Table 1. The Stages of Establishment and Development of Financial Management

Development Stages	Prerequisites to the Development	Research Priorities in the Financial Management of Enterprises
1st stage 1860s	– necessity to store public revenue in the treasuries of states; – accounting and administration of the state-owned sector of the economy.	- systematic approach to the description of financial science; - formation of knowledge, skills, and methods of public finance management; - foundations of the classical theory of finance.
2nd stage 1990s	- rapid development of the commodity market; - necessity to mobilize financial resources; - necessity to apply various financial methods and tools.	- legal and financial mechanisms for association and merger of various enterprises; - establishment of new firms; - issuance of various securities in order to attract additional money and capital growth.
3rd stage 1930s	- exacerbation of the economic crisis of that years; - necessity to identify mechanisms of financial recovery and elimination of negative trends at the enterprises.	- fundamentals of crisis management of finance; - development of methods for bankruptcy forecasting; - techniques of managing cash flows; - assessment of assets liquidity.
4th stage from 1950 to1980	- necessity for efficient formation and utilization of financial resources of the leading companies.	- budgeting framework; - portfolio theory; - asset valuation models; - capital structure theory; - dividend policy.
5th stage from 1980 to the present day	- brisk growth of the national economies; - enlarged application of new financial instruments; - globalisation patterns.	- active development of the financial management; - conceptualisation of the value-based management; - designation of organization models; - integral indicators of performance.

The first stage in the establishment and development of financial management (the 1760s) is characterized by the formation of a systematic approach to the description of financial science. During this period, the necessity to store public revenue in the treasuries of states, as well as the further accounting and administration of the state-owned sector of the economy, were designing the development of knowledge, skills, and methods for managing public finance. Thus, in the middle of the 18th century, the finance as a science emerged into an independent branch of so-called cameral sciences. Cameralistics (from Latin *camera* – the palace treasury or the state treasury as a place for storage of public revenue), developed in Germany in the 17th-18th centuries, represented a report of administrative and economic knowledge on the conduct of cameral or palace, and, in a broad sense, state economy. In those years, the term 'finance' was univocally treated as state funds, received in the form of money, materials, services. The founders of the new scientific school are considered German scholars Johannes Justi (1720-1771) and Joseph Sonnenfels (1732-1817), in their monographs that came out in the mid-1760s, for the first time they gave a systematic description of the financial science. Later, the body of knowledge, skills, and methods of public finance management and public unions came to be called the classical theory of finance.

The second stage of the establishment and development of financial management occurred in the 1890s and lasted until the early 1930s. The rapid development of the commodity market, the necessity to mobilize financial resources and apply various financial methods and tools resulted in the activities of enterprises led to in-depth study of issues in the financial management. During this period, the accounting, economic and financial areas of management separated; the search and assessment of funding sources for enterprises and the potential growth of financial resources in the process of business expansion through the external sources such as issuing securities, forming organizational and economic bases for enterprises' association, appeared as key financial problems.

The development of legal and financial mechanisms for corporate restructuring, the establishment of new firms, the issuance of various securities, aimed at the attraction of additional money and capital growth became the key research findings in the corporate finance management. As a result, the first large-scale wave of mergers and acquisitions took place during this period, the first financial and industrial groups and associations appeared.

The third stage of financial management development (1930-1950) determined the formation of an independent financial function in the management of an enterprise. The global economic crisis of the 1930s, which led to the bankruptcy of some companies and the emergence of a large number of successful investment opportunities for the others, identified, on the one hand, the necessity to find effective financial mechanisms for recovery and elimination of negative trends at enterprises, on the other hand, resulted in the of methods and techniques of analysis and evaluation of companies' investment attractiveness.

Therefore, in 1938 the American economist John Williams (1900–1989) in his famous scientific work 'The Theory of Investment Value' proposed a formula for determining the intrinsic value of a share.

He developed his approach on the dividend income by applying the discount method and proceeded from the fact that the internal price of the share is equal to the present (or discounted) value of all future dividends. He also believed that the quantitative assessment of the value of equity rights plays a key role in the analysis of investment projects and selection of alternative financing options.

In 1939, British economist John Richard Hicks (1904-1989), 1972 Nobel Laureate in Economics, published his famous work 'Value and Capital: An Inquiry into some Fundamental Principles of Economic Theory'. In his writing, the author developed the concept of time value of money by applying the techniques elaborated by him, such as comparative statistics and dynamic analysis. At large, its concept is premised on the considerations of the price of capital, risk, and inflation [3].

In general, during this period, the research findings in the financial management included also the development of the fundamentals of crisis management of corporate finance, methods for bankruptcy forecasting, techniques of managing cash flows, liquidity management, as well as problems of financial analysis, financial planning, budgeting and financial modeling, based on accounting.

The fourth period (1950-1980) marked the emergence of financial management as a science and a full-fledged branch of financial science. The majority of national economies became engaged in the processes of their integration into the world economic space, accompanied by the scientific-and-technological advance and the necessity to attract significant investments and their evaluation. A new group of mercenary financial managers began to appear, which could deal with financial activities in stock markets, design investment portfolios and gradually the owners of companies began to withdraw from operational management of enterprises. In turn, the investment theory received a new round of development in science. A majority of the scientists, who explored the conceptual and methodological foundations of financial management during this period, became the Nobel Prize laureates in the future. Their developments dealt with the following areas of financial management development:

- fair value measurements (investment attractiveness) of various types of financial instruments;
- investment portfolio theories;
- capital structure theories;
- asset valuation models;
- budgeting framework;
- benefits management and dividend policy.

We turn our attention to the main scientific works of famous economists of the relevant periods that have made a significant contribution to the establishment and development of financial management as a science.

The American economist Harry Markowitz (born in 1927, 1990 Nobel Laureate in Economics) in the work ‘Portfolio Selection’ (1952) described and proved the theory ‘Optimal Portfolio of Risky Assets’ [4]. The basis of this theory is the concept of income and risk. The author first proposed indicators to measure the risk of securities, because before it was estimated intuitively. The paper also postulates that in order to minimize the risk the investors should combine risky assets in the portfolio, and the level of risk for each type of asset should not be measured separately, but its impact on the overall risk level of a diversified portfolio of investments should be taken into account. The scientist’s works on the theory of portfolio created grounds for a microanalysis of finance as one of the important branches of modern economic analysis. Today, investment managers are familiar with the elements of normative mean-variance theory, providing a basis for assessing the degree of risk of the investment in securities.

The works of such well-known representatives of the neoclassical theory of corporate finance of Franko Modigliani (1918-2003) and Merton Miller (1923-2000) ‘The Cost of Capital, Corporation Finance and the Theory of Investment’ (1958) and ‘Dividend policy, growth and the valuation of shares’ (1961) also merit our attention [5]. They are the authors of the ‘Capital Structure Theory’, according to which in the financial market the value of equity rights is determined by the capitalization rate of expected income and does not depend on the structure of its capital. Modified Modigliani-Miller theorem (hereinafter referred to as MM) with allowance for the cost factor for an elimination of the financial difficulties argues that the existence of a certain share of borrowed capital is beneficial to the company, but its excessive use is harmful, and there is an optimal share of the borrowed capital for each organization. For their achievements, the authors became laureates of the Nobel Prize in economics of 1985 and 1990, respectively.

In 1962, in the ‘The Investment, Financing, and Valuation of the Corporation’ the American economist Myron Gordon (1920-2010) developed a model of his name ‘Gordon Growth Model’, in which for the first time the discounted cash flow method was applied in corporate financial management for the modeling of owners' equity prices [6].

The works of the academic economist of the Stanford University, USA, William Sharpe (born in 1934) deserves attention during this period. In his work ‘Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk’, published in 1964, the author described the theory of financial assets pricing, identifying two types of risks of the investments in securities: systematic and unsystematic. Second, he is the author of the Capital Asset Pricing Model – CAPM, on its basis the corporation can determine the price of capital required to run a business. Today this model is still used by the economists [7].

The last fifth stage in the development of financial management covers the period from 1980 to the present time. This period is characterized by the globalization processes of the development of national economies, the integration of theoretical conclusions of various scientific schools (American, European, Japanese and others) concerning the basic conceptual approaches to the management of an enterprise.

The results of academic pursuits in financial management were the development of new financial instruments and financial technologies in the area of corporate finance management (concepts of the value-based management, designation of organisation models, integral indicators of enterprise performance, the principles and models of financial support for enterprise's sustainable growth, the system of methods for fundamental analysis of financial market conjuncture). In addition, a new branch of financial science – financial engineering began to evolve.

Certain theories and models of financial management that emerged in this period will be considered.

It stands to mention the famous academic economist of this period Gordon Donaldson (born in 1931), an expert in corporate financial management who had an enormous influence at Harvard Business School (HBS) as a professor, mentor, researcher, and administrator from 1955 to 1993. In his work 'Managing Corporate Wealth' (1984) developed the concept of subordination or Pecking Order of the sources of capital structure formation, later became known as hierarchy theory [8]. Essentially, enterprises should first use internal financial sources such as profit and depreciation. The dividend rate should correspond to the needs of future investments. If it is necessary to attract external sources, there should be such a sequence: bank loans, the issue of convertible bonds and, finally, the issue of shares.

Based on the comparative analysis of the theories of MM and G. Donaldson, Stewart C. Myers developed the theory of asymmetric information. The theory of asymmetric information implies that the scope, completeness, and quality of information about the financial condition of the corporation available to its managers may differ significantly from that, received by the investors [9]. According to S. Myers, in order to eliminate the inequality of access to information, corporate managers should take care of the dissemination of favorable information, and then investors will pay more for the shares of the corporation. For instance, when a company increases dividends and expands its investments, the price of its shares on the market increases and, conversely, when dividends are decreasing, investments are reducing, and the company attracts new additional sources of financing, its stock price falls.

The Canadian economist Myron Samuel Scholes (born in 1941) is another prominent scholar of this period, who was awarded the Nobel Prize in Economics in 1997 'for a new method to determine the value of derivatives', what is important for the development of financial management [10]. In his work 'The Pricing of Options and Corporate Liabilities', the author developed a method for determining the value of an option that does not require an application of a specific risk premium.

4. CONCLUSIONS

Thus, a retrospective analysis of the major stages of establishment and development of the financial management allows us to conclude that financial management as a science emerged in the mid-twentieth century in the countries with market economies under these preconditions:

- the foundations for a general theory of market economy were laid;
- the industrial management, based on large-scale production and public ownership, reached high development level;
- the market infrastructure was formed, involving an effective system of legal institutions;

- the system of financial intermediaries evolved both within countries and international financial institutions;
- reinforced competition in the financial and commodity markets;
- increased role of the intellectual component of the economy.

Over the hundred-year period of its existence, the financial management has significantly extended the range of studied problems – at its inception, it considered mainly the financial issues of the establishment of new companies, and later – the management of financial investments and bankruptcy problems, and now it includes virtually all areas of corporate finance management. In recent years, a number of financial management issues have received in-depth development in new, independent knowledge areas – financial analysis, investment management, risk management, crisis management of enterprise under the threat of bankruptcy.

Under globalizing world economy, universalization of the world's information processes and complication of the system of internal and external financial relations of economic entities, the necessity for a long-term financial forecasting and planning, application of new financial instruments and leverages, better understanding of the mechanism of international finance, development of specialized information systems to support financial decisions became obvious.

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