REVIEW PAPER
UDK: 338:339.137.2(497.11) ; 336.76
Date of Receipt: December 21, 2012

Dejan Malinić

Faculty of Economics
University of Belgrade
Department of Accounting and
Business Finance, Belgrade

Vlade Milićević

Faculty of Economics
University of Belgrade
Department of Accounting and
Business Finance, Belgrade

OVERCOMING FINANCIAL STRUCTURAL DISORDERS AS A PREREQUISITE FOR STRENGTHENING THE COMPETITIVENESS OF SERBIAN ECONOMY*

Prevazilaženje finansijsko-strukturnih poremećaja kao preduslov jačanja konkurentnosti srpske privrede

Abstract

From the present point of view, we may conclude that, besides the usual incompleteness of legal framework, lack of corporate culture, extremely long and still unfinished privatization, which was mostly inadequate and implemented inefficiently, accumulated financial structural problems in our companies, whose origin dates back to the early 1990s of the last century, pose an additional burden restraining Serbian economy to finally find the right path for the exit from the crisis. Nowadays, at almost every step, we witness consequences resulted from many years of underestimating financial structural problems and even lack of understanding by those who should point the way towards the recovery of exhausted Serbian economy. All these consequences could be unified by the statement that our economy is still mostly immature to deal with a very tough competition awaiting it at a global level. Without raising the competitiveness of national economy, it is hard to believe the stories of its improvement in any segment, of higher employment, raising standards and any other socioeconomic well-being. The following paper advocates this very idea and offers several concrete solutions, which, along with some other systemic measures, should enable long-awaited recovery of Serbian economy.

Key words: *competitiveness, liquidity, indebtedness, profitability, investment capabilities, capital expenditure, sustainable growth*

Sažetak

Sa ovdašnje vremenske distance može se zaključiti da pored uobičajene nedorečenosti pravnog okvira, nedostatka korporativne kulture, izrazito duge i još uvek nezavršene privatizacije koja je u velikom broju slučajeva neadekvatno i neefikasno sprovedena, nagomilani finansijsko-strukturni problemi u našim preduzećima predstavljaju dodatnu balast koja sputava privredu Republike Srbije da u skorije vreme konačno pronađe prave puteve za izlazak iz krize čiji počeci sežu još od početka devedesetih godina prethodnog veka. Posledice višegodišnjeg potcenjivanja finansijsko-strukturnih problema, pa i nerazumevanja od strane onih koji bi trebalo da trasiraju puteve oporavka iznurene srpske privrede, vidljive su danas skoro na svakom koraku. Sve te posledice mogle bi se objediniti u konstataciji da naša privreda u najvećem delu još uvek nije dorasla za nadmetanje u veoma oštroj konkurentskoj utakmici koja je očekuje na globalnom nivou. Bez podizanja njene konkurentnosti teško je poverovati u priče o bilo kakvom napretku nacionalne ekonomije, većoj zaposlenosti, poboljšanju standarda i svakom drugom društveno-ekonomskom boljitku. Rad koji je pred vama promoviše upravo ovu ideju i nudi nekoliko konkretnih rešenja koja bi u sadejstvu sa nekim drugim sistemskim merama, trebala da omoguće dugo očekivani oporavak srpske privrede.

Ključne reči: *konkurentnost, likvidnost, zaduženost, profitabilnost, investicione mogućnosti, kapitalna ulaganja, održiv rast*

Introduction

It is the fact that we are constantly exposed to information regarding macroeconomic stabilisation, budget deficit, efficiency of economic and financial sector, needs to reconsider growth models, problems of increasing economic activity, necessity of promoting export, addressing unemployment problems and so on. What is common to such issues are very different projections of necessary increase in economic activity and rate of GDP growth. In our opinion, it happens due to a fact that creators of such projections often accept without enough criticism various optimistic scenarios, or without any deeper consideration of problems and potentials of economy and certain sectors belonging to it. Choosing to research thoroughly the

* This edition is dedicated to the project financed by the Ministry of Education, Science and Technological Development titled "Strategic and tactical measures to overcome real sector competitiveness crisis in Serbia" (no. 179050, period 2011-2014).

financial structural and return position of our economy within a reasonable time sequence, we tried to present the problems from the perspective of financial strength of the economy generating GDP.

Undoubtedly, every crisis situation is usually followed by serious financial structural disorders. They are particularly present in the national economies that have not come out of the transition process, where structural reforms have not been finished and where there are no possibilities for differentiating sources and cutting financing costs, due to undeveloped capital markets. Logically, such economies faced the economic crisis completely unprepared, and, consequently, their exit from the crisis is much more complex. This is because in projecting economic measures leading towards the exit of the crisis we cannot, by any chance, ignore financial structural heritage related to indebtedness level, illiquidity, technical and technological outdatedness, presence of operating and financial risks, possibility of sustainable growth and so on. Potential solutions that ignore these problems and neglect analysis of their causes are doomed to a failure at the very beginning.

Having in mind the previous observations, we consider that creating strategy for overcoming the crisis in Serbian economy (hereinafter RS) is not possible without previous evaluation of current state. In that sense, assessment of the existent economic performances aims to provide the insight into the seriousness and depth of financial structural disorders, to reveal us to what extent the inherited situation is a burden in taking the necessary changing steps, as well as to help us, eventually, to find the most efficient solutions. This paper is practically the culmination of our extensive research on financial structural and return position of Serbian economy from 2007 to 2011. We published the results we obtained during the research that lasted more than a year in several papers listed in references. As it is obvious from these papers, we equally dealt with the economy as a whole and with finding the sectors that could become the propellers of economic activity in the years to come. The following paper represents the sublimation of the efforts made in this respect, and it contains only key recommendations grounded on the results of thorough analysis regarding financial statements of economic entities.

Financial structural problems of the economy

Conducted research regarding the movement of performances from 2007 to 2011 allows us, first of all, to point in this paper to several problems representing a huge burden for the exit of many years of crisis for the economy of RS (see more about this in [8] and [10]). Although the list of these problems could be very long, we decided to present, at this point, only the most important, such as: illiquidity problem, indebtedness problem, problem of decreased equity, problem of financial imbalance and lack of Net Working Capital (hereinafter NWC), problem of low profit margins, problem of inefficient management over assets and equity, problem of negative financial leverage and problem of limited possibilities regarding financing growth. Let us look briefly at the most important aspects each of these.

Illiquidity problem has been a huge burden for the economy of RS for many years. With the first strike of economic crisis, precisely in 2008, this problem began to escalate sharply. Based on conducted research of the achievements of economy and its key sectors, at the beginning, we could state that the problem of providing liquidity of our economy has several important aspects.

Firstly, providing long-term economic liquidity complicates the unfavourable financial structural position, i.e. compromised relation between current assets, on one hand, and current liabilities on the other hand. This happens because of growing short-term borrowing, dramatic postponement in payment of liabilities to suppliers and employees, as well as liabilities regarding interests and other operating liabilities. Along with this, we should point out that, in the analysed period (except in 2007), there are negative values of NWC reported, with a strong tendency to continue its deterioration, which speaks for itself in terms of the difficulty to improve liquidity position of the economy for a long-term.

Secondly, insufficient range of operating activity, followed by accumulating inventories which find their way to buyers with more and more difficulty, as by accumulating receivables which are collected with difficulty and long delay due to overall illiquidity, and thus represent a special burden for the liquidity of economy. This happens because the prolongation of Average No. Days Inventory in Stock and Average No. Days Receivables Outstanding extends the length of operating cycle and, consequently, the period necessary to provide current assets financing. Assuming that the economy will rely on suppliers (to a reasonable degree) as a spontaneous financing source, this also means that, due to extending the length of operating cycle, it will be necessary to provide larger and larger amount of additional, mostly borrowed sources (i.e. loans). Finally, we should not neglect the fact that, due to accumulating inventories and receivables, the inflow of revenues will be cut to a degree that would enable coverage of costs made and obtaining sufficient incomes.

Thirdly, the previous assumption on reasonable use of suppliers as a source of financing operating cycle is not applicable in our economy in the analysed period. Instead, we are free to claim that suppliers are those who bear the greatest burden of illiquidity in the economy of RS. This happens because, in the analysed years, the average period for settling liabilities to suppliers is about four months. In certain sector, that period reaches even seven months [9]. Consequently, cash cycles are negative in sectors of telecommunications, processing industry, construction, commerce and agriculture. At the same time, it means that suppliers, as a spontaneous financing source, are also used for financing some capital expenditure, which is, speaking long term, an unsustainable practice. Such abuse, to put it that way, is present in other sectors as well, but in a smaller degree. To make things worse, similar logic for the defence of own liquidity is also applied by suppliers themselves in their treatment of their own suppliers and so on. Thus, the illiquidity problem in our economy takes on the effect of spiral, pulling all companies to a bottom, especially those closer to its end.

Fourth, the lack of cash flow synchronization, especially regarding cash flow obtained from operating activities, pressures most strongly the liquidity of our economy. Namely, since the economy generates negative net cash flow from operations (hereinafter CFO), there is no possibility of maintaining liquidity, nor any other coverage of current liabilities, interest expenses or capital expenditure. Such achievements raise further not only the short-term financial risks, but also the long-term ones, and make it more difficult to attract new investments. In this regard, there is an especially worrying fact that the economy reports net outflows from income statement in almost each analysed year. To tell the truth, the last analysed year is an exception, but not due to the increase of operating efficiency in the economy, but due to raising the value of dinar on the date of the balance sheet. To be precise, owing to extrusion of foreign exchange losses, the economy reports net income in 2011, which resulted, among others, in the recovery of its net cash flow from operations.

However, something like that definitely cannot be expected in 2012. Namely, since it is certain even now that the value of dinar decreases, in financial statements for 2012, there will be a considerable increase of financial expenses and foreign exchange losses within them, probably reappearance of losses, and, finally, negative net cash flow from operations. All this speaks convincingly enough in favour of the fact that the indication of final balance established between inflows and outflows of cash flow from operations is still far away, as well as the improvement of liquidity position of our economy.

Growth of indebtedness in the economy is a general characteristic of the previous five-year period. We have already underlined that short-term indebtedness was far more expressed. This escalated especially after 2008. Owing to more frequent reaching for expensive, short-term loans, the costs of using borrowed equity rose considerably, and the bar for return achievements was raised to the level which is, as we are about to see later, unattainable for our economy. Along with the growth of indebtedness, burdening of the economy with interest costs, foreign exchange losses and other financial expenses arising from currency clauses of the approved loans, becomes practically unbearable. It is reflected by the fact that the expenses of financing almost tripled in the analysed period, while in the same period, the economy did not manage to provide their coverage, either by the achieved EBIT (Earnings Before Interest and Tax), or by free net cash flow from operations. In the entire analysed period, burdening with foreign exchange losses is so expressed that, in years with the depreciation of dinar value, they annulled all the effort put by the economy to achieve operating incomes. A final epilogue of this story is the fact that our economy, in the process of repaying accumulated debts, cannot rely in any part on the internal sources (primarily free net cash flow from operations), which speaks for itself about how much the position of long-term financial safety is jeopardised.

Reduction in the value of equity is the back side of the problem regarding growth of indebtedness in the economy and one more unfavourable signal awaiting long-term creditors in the field of long-term financial safety. Having in mind all cumulated losses, we may state that the share of net equity in total equity fell from almost 55% at the beginning of the analysed period to only 37% at the end of it. In order to complete the picture on relative level of equity put at the disposal of our economy, we must state two more relevant facts. Firstly, cumulated losses more than doubled in the analysed period. Except in 2007, cumulated losses took more than one third of equity in each following year. Secondly, we should not neglect the fact that there are a considerable number of companies within our economy which lost the entire equity through their operations. It is interesting to notice that, in previous five-year period, the amount of such losses increased by 3.5 times, where, according to all facts, we can expect this unfavourable trend to continue. Due to the aforementioned, net equity was not enough, in any of these years, to cover long-term, i.e. risky investments in fixed assets (there is a negative net working capital – NWC), which is one more important indicator speaking in favour of compromised long-term financial safety of the economy.

Problem of financial imbalance and the lack of net working capital is a logical consequence of the growth of short-term borrowing and collapse of equity. It is interesting to notice that the gap between necessary long-term financing sources on the one hand, and long-term investments, on the other, has become deeper from year to year. It happens despite the fact that, at the level of the economy in the last five years, investments in fixed assets have grown slightly. Unfortunately, it is also typical of investments in property, plants and equipment, i.e. in production and sales capacities of the economy, which does not indicate bright future, especially if we have in mind that a great part of this increase arises from revaluation. However, regardless of the above-mentioned, the economy of RS can do nothing but to increase the share of short-term sources in financing long-term related assets, which, so far, has sparked even more the negative effects of the previously mentioned problems on long-term financial stability.

Problem of low profit margins is one more characteristic of the economy of RS. Those margins are the consequence of both low profit achievements and small range of activities, i.e. unsatisfactory sales revenues. Let us notice that, up to 2011, the economy reported serious losses.[1] At the same time, the economy generated the excess of revenues over costs in its most important segment, the so-called core business (where, normally, there are main profit sources), in all analysed years. However, in this case it is not enough for profitable economic operations since the margins of gross and net operating income are very modest in all years. So, in the entire period, gross operating income is about 35% and that is certainly not enough. It is because the remainder from 100 in relation to this margin practically reflects the share of variable costs (i.e. costs of material and purchase cost of goods sold) which, on average, equals about 65%. Generally speaking, this is a very low burden to revenues, so we can hardly expect favourable operating profit from the remainder. The situation is even worse with net operating income which does not reach 5% in any of these years. Almost nothing would change, even if we turned our attention towards EBIT margins which, in the analysed period, go from 4.6 to 6.7%. This is because such achievements are definitely insufficient to provide the profitability of economy which is forced, on average, to borrow at higher cost of debt which, in the analysed period and calculated for the average debt amount, goes from 12.8 to 22% [10, p. 139].

Problem of low efficiency in management over assets and equity multiplies the effect of low profit margins to the profitability of economy. In previous explanation of liquidity problem, we have been speaking about the

1 Mind that, in thorough analysis, we established that the net income achieved in 2011 did not appear as the result of increasing operating efficiency of the economy, but as the result of significant reduction of financial expenses compared to 2010. It happened owing to the extrusion of foreign exchange losses, since on the day of balance sheet issue, 31/12/2011, dinar appreciated slightly towards euro, from 105.5 to 104.64 dinars. See more about this and the other consequences of toying with the exchange rate in [10, pp. 138-140].

consequences of delaying Average No. Days Inventory in Stock and Average No. Days Receivables Outstanding. At this point, it is important to state that the main propeller of assets turnover is hushed by delaying these processes. Furthermore, we must notice that a considerable growth of assets turnover did not happen, despite the modest growth of investments in certain parts of assets. To be precise, due to slower growth of sales revenues compared to growth of investments in assets, assets turnover did not exceed 0.80 in the whole analysed period. Besides, it is important to stress that assets turnover fell slowly from the beginning. Such achievements unequivocally indicate the small range of economic activity and insufficient usage of the existent capacities. However, knowing that the major part of our economy is supplied with outdated equipment which, regardless of this fact, is not used enough, the expectations in terms of more significant revenue growth were obviously unrealistic.

Previous two problems, i.e. problem of low profit margins and problem of small turnover of assets and equity, have definitely influenced *the profitability of our economy*, which is the next big problem. The profitability of our economy is simply unsatisfactory and it is manifested through *negative effect of financial leverage* which is present in all analysed years. At the same time, it shows us that the economy is not able to cover the cost of debt by the achieved profit. In other words, return on assets (ROA) is, during the whole period, below cost of debt, so the negative effects overflow to return on equity (ROE), creating the situation where the value of ROE is below the value of ROA. What speaks even more unfavourably of the profitability of our economy are very low values of ROA which do not exceed 5%, while the values of ROE are negative in three out of five analysed years. Due to all of the above-mentioned, instead of normally expected increase in owners' fortune, it is decreased, so it will be very difficult to attract new investors in such circumstances.

Problem of limited investment capabilities considerably limited the economic growth in the analysed period. In normal business circumstances, growth could be financed by combining internal (net cash flow from operations, retained income and amortization) and external sources, as proprietary sources (the issue of shares), as debt funds (bonds and loans). However, due to previously elaborated lack of cash flow from operations excess, lack of incomes and mostly written off financial investments, our economy, during the whole analysed period, could hardly rely on the internal financing sources. At the same time, due to undeveloped capital market, proprietary financing sources also are disappointing. The obvious consequence of such state is the inability to differentiate financing sources on one hand, and reduction of financing costs on the other hand, which significantly limited the maneuvering space for economic entities. In such circumstances, if the economy wants to finance growth, it can do nothing but increase indebtedness with all the accompanying financial structural risks and the risk of generating negative effect of financial leverage. In the analysed period, borrowing was done under extremely unfavourable conditions. The economic crisis, lack of equity at global level and great cautiousness of potential investors took care of a great part of it. Since the indebtedness was followed by currency clause, apart from numerous securities, frequent fluctuations in dinar exchange rate (precisely dinar depreciation) in our circumstances additionally increased the price of such financing, which has already been elaborated.

Key challenges in resolving financial structural disorders

Many national economies felt the consequences of global economic crisis, regardless of the level of their development. The intensity of the effects of crisis and the range of consequences were, of course, different, depending on their (un)readiness to cope with the forthcoming challenges of crisis, inherited structural problems, present financial imbalances, synchronization of the activities in real and financial sector etc. Of course, Serbian economy also suffers serious consequences of the economic crisis. However, in order to adequately perceive the possibilities and ways out of the crisis, we must admit that financial staggering of our economy is not caused only by global economic crisis. We could say that it is much longer process. As financial structural imbalances did not appear only as a result of global economic crisis, so we cannot expect that they will vanish with its termination. Although we would rather blame someone else for financial structural problems which would vanish with the termination of the crisis, it is, of course, not possible.

Serbia entered the global economic crisis with impotent economy, low competitiveness and high systemic risk [5]. We could freely say that, even before the economic crisis, Serbian economy had quite suffered the consequences of the so-called strategic crisis (deterioration of competitiveness, technical and technological outdatedness, lack of high-quality products, lack of markets, etc.), profitability crisis (fall of returns, burdening with losses, reduction of equity, lack of internal financing sources etc.) and liquidity crisis (inability to service liabilities, difficulties in borrowing, etc.). Years of warnings that financial structural risks were extremely high remained without reply. As time went by, ignoring reality resulted in more complex and painful solutions. Unfavourable transitional heritage did only additionally deepen the consequences of global economic crisis.

On the previous pages, we identified extremely hard financial structural heritage manifested through growing losses, worrying reduction of equity, unsatisfactory profitability (additionally threatened by the insufficient level of operating activities, low efficiency and high financial expenses) and chronic illiquidity, which require serious approach to this problem. With such financial structural imbalances, it is unrealistic to expect from Serbian economy to achieve any serious growth. Of course, the major question is what is to be done in order to solve the identified problems. In that sense, based on research done so far in the field of financial structural problems, we are turning our attention to several key challenges.

Ways of resolving illiquidity problem. Illiquidity is a chronic problem of Serbian economy. However, it is not the first problem in the chain of crisis burst. It appears as the result of fall in competitiveness, fall in profitability and financial structural disorders. However, the illiquidity crisis was manifested with the greatest intensity. Lasting incapability of payment, existing when a debtor cannot service his or her liabilities in 45 days (from maturity date) or when he or she completely suspends all payments in sequence of 30 days, is one of the reasons to start bankruptcy proceedings [14]. Furthermore, the complexity of resolving these problems reflects in the fact that long-term solution of illiquidity problem requires establishing competitiveness, increasing profitability and removing financial structural imbalance.

Resolving the illiquidity problem implies its comprehension. That problem could be simply presented as the imbalance between purchases done and disposable cash. In that sense, advocating multilateral compensations is questionable. To be precise, multilateral compensations cannot solve the illiquidity problem. It is because there would remain huge unsettled balance after performing multilateral compensations, as the result of previously mentioned imbalance between purchase and disposable cash. In favour of this, there is negative cash flow from operations indicating the inability to service liabilities from operating activities, even in case of inappropriate abuse of suppliers. If we also add the need to finance at least a part of capital investments from internal sources, debt repayment and dividend payment, we can get better picture regarding the seriousness of illiquidity problem. In such conditions, applying multilateral compensations could represent a time-limited measure which must not become a rule. By definition, it refers to old debts. In that sense, it can help in partial balance sheet adjustments by compensation participants, but those compensations do not bring fresh money, so they cannot solve future liquidity problems. In other words, multilateral compensations cannot reduce negative balance, as well as the consequences of illiquidity. After all, experience has taught us that the scopes of multilateral compensations in Serbian economy have so far been relatively modest and have not resolved illiquidity problems. Based on these relations, balance sheet adjustments themselves are preferable, but not enough to remove financial structural disorders.

One of crucial conditions for the improvement of liquidity position is strict financial discipline. It is also necessary to prevent the abuse of small suppliers by big, powerful companies. This is necessary to prevent, because the evasion of paying liabilities to suppliers leads even healthy parts of the economy into illiquidity. Financial discipline, as an expression of good business practice, is uncontested. What could be contentious is the regulation of legal deadlines for servicing liabilities.

Whatever the prescribed period (45 or 60 days), it will not be universally applicable. Sectors, even branches within them, are so different that it is impossible to imagine that the deadlines will suit all of them. All those who usually practice longer deadlines in doing business (than those potentially prescribed) will be in trouble. Also, such legal solutions would stimulate a certain number of companies which settle their liabilities in shorter deadline to prolong those liabilities to the prescribed deadline, which is also not good. After all, the analysis of liquidity, performed at the level of whole economy and key strategic sectors, indicates clearly that lengths of operating and cash cycle are very different.

Instead of legally imposed deadlines, perhaps a better solution would be, in conditions of breaking deadlines, to turn so far non-interest-related liabilities into interest-related ones. In that way, the possibility of settling liabilities as a part of contractual obligations would be kept, and the space for abusing suppliers as free financing source would be considerably limited. If we add to all that the necessity of efficient implementation of Law on Bankruptcy Proceedings, we could consider it a good option in establishing financial discipline.

Furthermore, we should consider carefully the consequences regarding thoughtless establishing of certain legal forms of companies. Here we mean particularly private limited liability companies. The latest Company Law prescribed nonsensical 100 dinars as a minimum amount of initial founding capital [13]. We forget that these private limited liability companies have owners who are responsible for taken liabilities only to the amount of initial capital invested. It is not worth wasting words on discussing safety of such companies, their possibilities of borrowing and risks. The facility of company founding increases their number, as well as the number of those who do not settle their liabilities and who practice frauds. The possibility of paying creditors' receivables practically does not exist in bankruptcy proceedings. Of course, here we do not mean those companies which, owing to their profitability or higher stakes, formed a respectable amount of capital in their operations.

We should also mention the need for more rigid control of potential abuses which could affect liquidity. Here we mean the abuse of postponing exchange differences in order to report more favourable incomes and pay them out in form of dividends. These outflows could be significant, especially when it comes to companies whose founders are not companies operating in Serbia. There in a particularly interesting fact that such a possibility is authorized by the government and opposed to the International Accounting Standards whose application is regulated by the law. Of course, dividend payment is not disputable as a corporate decision, but artificial income shaping, with the aim to achieve this, is not allowed. At the same time, this is directly opposed to the logic of corporations' functioning where owners' interests have a residual character.

To all of the above-mentioned, we should add the necessity of efficient cash flow management. In that sense, we should pay attention to managing the cash gap (inventory days on hands + receivables collection period – accounts payable period = cash gap). Through cash gap management, we can understand how the efficiency of performing operating activities affects cash flows [3]. For cash gap, we have to provide additional financing sources, which is mostly done by taking short-term loans. In that case, daily interest costs based on financing the cash gap could be easily calculated. Every day of cash gap reduction means reducing the need for cash and daily savings in interest costs. Raising the efficiency of management over inventories and shortening the period of receivables payment are key management levers. We deliberately do not mention the option of prolonging liabilities to suppliers, since this option has been much abused in Serbian practice.

Improvement of management quality. Accepting market rules of doing business and change of ownership relations as direct results of transition process should have resulted, among others, in raising management quality. The imperative of maximizing companies' value implies program improvements, more intense investments and rational use of resources, which should bring about growth of profitability, employment and GDP. Generally speaking, it did not happen at the national economy level. Modest increase of operating revenues could be attributed to insufficient product and price competitiveness, inherited technical and technological outdatedness, bad positioning, difficulties in obtaining additional capital etc. It is understandable up to a point, especially if we have in mind the previous years' situation regarding economic sanctions, ravages of war, insufficient development of capital market and so on. However, lagging behind in terms of raising the internal efficiency is not expected. In order to illustrate the problem, it is enough to mention the fact that, in 2011, the range of economic activity grew by 12% (calculated by growth of operating revenues), while operating income margin fell by slightly more than 6% (find more details in [10]). It is widely known that, in conditions of revenue growth, operating income margin has to rise due to degression of fixed costs. In such conditions, it is unrealistic to expect the reaching of price competitiveness.

The improvement of management quality necessarily implies raising the quality of knowledge and continuous professional development. Investing in knowledge belongs to the costs that could bring to the increase of revenues and even faster increase of operating income. Management has to be familiar with new managing approaches and ready to implement them in practice. The implementation of cost calculation, dominantly for the purpose of financial reporting, and calculation of full cost price for the purpose of forming selling prices is far from being sufficient. Managing the company performances implies the overall approach to cost analysis down the whole value chain, including costs before the production process, costs during the production process and costs related to post-sales services [6, pp. 25-27]. Cost reduction and continuous improvement are good ways towards the creation of cost competitiveness.

Management has to be open for the implementation of the whole range of disposable strategic and operational management concepts and instruments, like: life-cycle costing, target costing, kaizen costing, activity-based costing, activity-based budgeting, total quality costing, environmental costing, inventory management, benchmarking, analysis of the competition, just-in-time system, customer profitability, inter-organizational cost management etc (see more about these concepts in [2, pp. 242-253] and [4, pp. 426-482]). Some of these approaches will be very helpful in strategy articulation, implementation and control and in creation of success potential, while many of them will serve to raise the operational efficiency. Having in mind that the efficiency improvement has no alternative, redesigning information supply is inevitable for management. Thereby, it is not management that should deal with creating information supply in terms of operationalizing previous concepts. It is responsible for recognizing needs, providing conditions for the creation and implementation of various concepts, which will require, among others, the appropriate management accounting skills. We could freely say that the implementation of contemporary concepts in performance management represents the inevitable way to the creation of cost competitiveness for companies. Consequently, raising management quality is a relevant profitability determinant. Since profitability also implies the increase of company's equity, it is the determinant of company's safety as well, and an inevitable prerequisite for the establishment of financial structural balance.

Unsustainability of high financial expenses. The performed analysis of profitability and financial position of Serbian economy showed, among others, the increase of indebtedness level and very serious burdening of the economy with financial expenses. In the period from 2006 to 2011, long-term liabilities and short-term financial liabilities increased by 2.5 times (where the increase of long-term liabilities equals 2.3 times and the increase of short-term financial liabilities equals 3 times), while financial expenses increased by 2.4 times. Thereby, cost of debt (for the average amount of debt) goes between 12,8% and 22% [10, pp. 145-147]. In such a situation, no deeper analysis is necessary to prove the unsustainability of such high financing expenses. These margins are inappropriate and even much more developed economies would not take them. Thereby, the height of financial expenses is determined by interest rate level, exchange differences and the incorporated currency clause. Since cost-of-debt level is the key determinant of financial risk, we could state that financial risk is very high. Other important component of financial risk is the inconstancy, i.e. unpredictability of financial expenses' level. During the analysed five-year period, tremendous cost-of-debt fluctuations additionally increase the financial risk.

Previous observations confirm the importance of macroeconomic stability for proper functioning of the economy. Cost-of-debt fluctuations are primarily the consequence of incorporated currency clauses and exchange differences. The rates of financial expenses were the lowest in 2007 and 2011 (about 12.8%) when the exchange rate was stable. Variations in the exchange rate have dramatic consequences to the economy. Thereby, advocating macroeconomic stability does not imply advocating fixed exchange rate. From our point of view, stability means advocating a clearly defined exchange regime which would reduce, at least, the unpredictability of financial expenses and respective financial risks.

A precondition for the exchange rate stabilization is curbing the inflation, i.e. reducing it to a reasonable level, certainly below 5%. The relations among inflation, interest rates and stock prices are familiar. This connection does not have to be direct and consistent, but it definitely exists [11, pp. 419-422]. It is well-known that credit institutions, in order to maintain targeted real returns, incorporate the inflation into interest rate, which affects the growth of inflation. When companies cannot shift the growth of production costs and financial expenses to their clients (due to price competitiveness), incomes and cash flow are reduced, and stock prices fall. The companies are not interesting to investors any more because shareholders' returns get smaller than the required creditors' returns. In such circumstances, companies slide into bankruptcy.

The unnatural alienation of financial and real sector has to be overcome. If people stopped believing that the long-term survival and development of financial sector is possible in the long term without real sector, it would certainly affect more cautious and responsible behaviour in setting conditions of economy crediting. Along with already mentioned and necessary monetary stability, in the process of creating conditions for cost-of-debt reduction, we should have in mind several important suggestions.

Firstly, the stability of banking system has to remain the strategic goal of banking market regulators. So the regulator, National Bank of Serbia (NBS), must be very cautious in terms of required relaxation of risks in those fields where there is no real ground for that.

Secondly, it is necessary to extend alternatives on the side of financial-source offer in order to reduce the monopolistic position of banking sector. Macroeconomic stability would certainly contribute to the attractiveness of corporate bonds as a financing source, while the appealing production programs could attract investors to common shares. The effect could be visible in the reduction of cost of debt.

Thirdly, it is necessary to raise the responsibility of bank management. By this, we mean the responsibility for wrong investments, since they are in charge of the evaluation of risks regarding investments and collateral and, accordingly, wrong decisions. Possible tendency to shift risks based on low-quality management to clients, through higher cost of debt, is unacceptable.

Fourth, it is necessary to reconsider the return sources of banking sector in order to clarify the lack of interest in real sector's destiny. The regulators' policies in terms of providing greater and cheaper economy crediting would probably, even then, be more effective. Banks must recognize their interest in crediting the economy and see their responsibility in that process.

Fifth, companies burdened with debts should not be inert. They need to keep in touch with creditors and, together with them, find the way for the relaxation of liabilities. It seems that creditors need to see their interest in resolving this problem. The unbearable pressure of high financial expenses is not only the problem of individual economic entities. They will certainly pay the price, but thereby, creditors as well will not be saved in many cases. We remind you that provided collateral, even supposing it is objectively estimated, is worth much less when the company goes bankrupt.

Besides the above-mentioned, we should have in mind that crisis cannot be overcome by extremely expensive loans. It should be vice versa. Money should be cheap. Judging by that, end of the crisis is not on the horizon.

Possibilities of financing sustainable growth of strategically important sectors. The fact is that not all the sectors have the same importance for the economic growth. In Serbia, sectors like agriculture, mining, processing industry and construction are often declared strategically important. Along with that, we would add the so-called infrastructural sectors like energy sector, telecommunications and transportation, which also possess a strategic character. Their importance comes especially from the fact that they have a multiplying effect on the growth of activities in other sectors. As the key infrastructural sectors, they represent the pillars of national economy development.

The above-mentioned strategic sectors are capital-intensive. It means that they imply large investments in new capacities and revitalization of the existing ones. Such activities could be performed only by financially healthy companies. However, as financial structural disorders are more or less present in all sectors, these sectors are faced with double challenge. Firstly, certain companies within these sectors have to improve their financial performances along the way, and secondly, they must look ahead in order to reach and maintain certain target capital structure. All this opens the issue of providing necessary sources for financing sustainable growth.

Financing sustainable growth in capital-intensive sectors which have already had the unresolved financial structure implies the differentiation of financing sources and their combining according to target capital structure. In that sense, we must count on internally generated and external financing sources. Raising management quality and imposing financial discipline should bring to the increase of cash flow from operations. If, along with that, we would manage to reduce financial expenses to a reasonable degree, it would mean that bigger part of internally generated cash flows remains on disposal for financing the capital expenditure. In certain cases, when financial balance is not significantly impaired and when projects are less requiring in financial sense, internally generated cash flow, in combination with credit sources, could provide maintaining the target capital structure.

For financing more capital-intensive projects, internally generated sources will not be enough. It is necessary to rely on external own financing sources. Regarding companies that already have financial structural problems, the exit should be sought in recapitalization. When it comes to attractive projects combined with necessary prerequisites for the functioning of capital markets, some companies should seek the solution in the issue of shares. At this point, it seems that such activities do not have great chances for success, but we should not rule them out as an option. In order to resolve financial structural problems and provide sustainable growth, a good solution could be the recapitalization by strategic partners. In certain strategically important companies, we should not rule out the State as a potential investor. In infrastructural sectors, we should open space for the inflow of fresh capital based on public-private partnerships.

Finally, partial financing of capital projects from debt as an external source is acceptable as well. Of course, this is an option provided that target capital structure is not impaired and that the effect of financial leverage is positive. However, compared to current situation where credit sources are dominant, the differentiation of borrowed sources is necessary. In that sense, we should rely on long-term debt instruments. Corporate bonds could be particularly interesting. The precondition for that is the development of primary and secondary capital market.

Encouraging healthy parts of the economy. In bringing conclusions on profitability and financial position of the economy based on summary financial statements, one should be very careful, since total net incomes (losses) appeared as the result of offsetting total net incomes with total net losses and that net equity implies the decrease of equity for the amount of losses reported in liabilities and assets of the balance sheet. In other words, it means that there are healthy parts of the economy with above average achievements. Consequently, there are also those other parts of the economy, branches and individual companies, burdened with serious losses which sometimes exceed the amount of equity.

The seriousness of the presented situation is supported by the information that from total number of companies, in 2011, 58.2% reported incomes, 34.1% reported losses, while 7.7% reported the zero income. Thereby, total net incomes were higher than total net losses by only 1.2 times. Let us add that in 2010, net losses were higher than net incomes by 1.3 times [1, p. 9]. Not a small part of companies has losses which are higher than the amount of capital. Such a situation, in the economy that operates according to market principles, is unsustainable for a long term. Tolerating losses is perhaps acceptable in the companies whose survival in society is necessary. In other cases, where losses seriously endanger the height of equity, there are two options. The first one implies admitting losses in capital, restructuring and recapitalization, of course, in places where it is justifiable and possible. On the other hand, companies that have been unprofitable for years, especially those with losses higher than equity and no future whatsoever, have to be market-sanctioned. From the point of view of national economy, it is generally not the problem to close one company. The problem is if there are no new companies opened, which, in total, would provide the growth of economic activity and the increase of employment. Such activities would reduce the risk that illiquid companies could bring healthy parts of the economy into illiquidity. The number of risky loans would also decrease, which would consequently have a positive influence on the reduction of financing expenses. Furthermore, the economy would get free of balance burden. So, growth should definitely be based on healthy parts of the economy.

Balance sheet adjustments. Previously described activities also represent a kind of balance sheet adjustments. However, by this we particularly mean adjustments in terms of excluding hidden losses. Hidden losses, appearing as the result of assets overrated and liabilities underestimated, are a very dangerous phenomenon. In this way, contaminated balance sheets, ceasing to be a reliable information source, bring the insecurity into decision-making process. It is certainly not in favour of the need to attract foreign investors. The causes of hidden losses could be sought in overrating intangible assets (excessive capitalization of expenses and the activation of expenses where it is forbidden, overrating the brand etc.), keeping the uncollectable receivables, leaving out potential liabilities etc. Responsibilities of management, auditors and accountants in this process are obvious. However, it is quite worrying that the government participates in the legalization of creating hidden losses. Thereby, we mean allowing companies to postpone the effects of foreign exchange losses (or gains) and currency clause for future periods, by separating them in balance sheet. Apart from risk in terms of making wrong decisions by the external stakeholders, there are possible damages based on paying increased tax liabilities, paying out the unearned bonuses and paying out unrealistic dividends [12, pp. 112-135].

Balance reality could also be supported by the objectivisation of excessive hidden reserves, which are essentially totally opposite to hidden losses. However, due to a fact that reasonable hidden reserves are desirable and that potential damages based on excessive hidden reserves are much smaller than damages caused by hidden losses, we will not discuss them further at this point.[2]

Rearrangement of company balance sheet would definitely contribute to raising the reporting power of financial statements. Higher statement credibility would bring to the increase of investor safety and reduction of the risk of adverse selection. Besides, providing safer insight into the financial position of the economy, sectors and individual branches, would reduce the risk of creating inadequate industry policies. Finally, the aim of establishing financial balance should be real performance state.

Conclusion

Financial structural heritage of Serbian economy represents a serious limitation for further growth of economic activities. In general, we could say that financial structural disorders are the result of decreased competitiveness and profitability of Serbian economy. However, there are much more factors that have affected general economic performances so far. Some of them are the result of external factors' activity (sanctions, structural disorders, long transition, crisis, high financing expenses etc.), while the others are internal (low efficiency, inability to find profitable projects, production and price competitiveness and so on). The major consequences are illiquidity, growth of indebtedness, reduction of equity, lack of net working capital, low profit margins, high financial expenses, negative effect of financial leverage, inability to finance sustainable growth and insufficient profitability.

Eliminating financial structural disorders is the prerequisite of growth in economic activities and strengthening the competitiveness of Serbian economy. In this paper, we stressed the key directions in resolving these problems, such as: ways of resolving illiquidity problem, necessity of management quality improvement, suggestions for the reduction of financial expenses,

2 See more about the potential risks based on hidden reserves in [7].

capabilities of financing sustainable growth of strategically important sectors, necessity of encouraging healthy parts of the economy and balance sheet adjustments in terms of excluding hidden losses. Regarding the issues discussed, we also mentioned some institutional assumptions for their solution, like macroeconomic stability, regulation stability, law implementation, development of capital market and raising the quality of financial reporting.

References

1. Agencija za privredne registre. (2012), *Saopštenje o poslovanju privrede u Republici Srbiji u 2011. godini*, available at http://www.apr.gov.rs/Portals/0/GFI/Makrosaopstenja/2011/Saopstenje.pdf.
2. Atkinson, A., Kaplan, R., Matsumura, E., Young, M. (2012), *Management Accounting: Information for Decision Making and Strategy Execution,* London, Pearson.
3. Boer, G. (1999), "Managing the Cash Gap", *Journal of Accountancy*, Vol. 188, No. 4, 27-32.
4. Drury, C. (2005), *Management Accounting for Business*, London, Thomson.
5. Đuričin, D., Vuksanović, I. (2012), "Isn't output more important than inflation in impotent economy: Serbia's economic policy revision", *Ekonomika preduzeća*, Vol. 60, No. 1-2, 13-32.
6. Hilton, R. (2009), *Managerial Accounting: Creating Value in a Dynamic Business Environment,* New York, McGraw-Hill.
7. Malinić, D. (2008), "Finansijsko izveštavanje kao determinanta kvaliteta korporativnog upravljanja", *Ekonomika preduzeća*, Vol. 56, Br. 1-2, 17-27.
8. Malinić, D., Milićević, V. (2011), "Performance Evaluation of Real Sector in Serbia", *Ekonomika preduzeća*, Vol. 59, No. 7-8, 335-351.
9. Malinić, D., Milićević, V. (2012), "Finansijska stabilnost sektora telekomunikacija u Srbiji", *Telekomunikacije*, 10, V, 2-15.
10. Malinić, D., Milićević, V. (2012), "Finansijsko–strukturno nasleđe kao ograničenje za izlazak privrede iz krize – Slučaj Republike Srbije", in *Zbornik radova: Značaj računovodstva, revizije i finansija u procesu prevladavanja ekonomske krize*, Banja Vrućica 2012, 119-149.
11. Reilly, F., Brown, K. (2003), *Investment Analysis and Portfolio Management,* Mason, Thomson.
12. Stevanović, N. (2009), "Bilansno-političke implikacije po kvalitet dobitka", *Ekonomika preduzeća,* Vol. 57, Br. 3-4,109-137.
13. Vlada Republike Srbije. (2012), *Zakon o privrednim društvima* (čl.135), Službeni glasnik RS, 36/11, 39/11.
14. Vlada Republike Srbije. (2012), *Zakon o stečajnom postupku*, Službeni glasnik RS 104/2009, 99/2011.

Dejan Malinić

is a full professor at the Faculty of Economics, Belgrade University. He teaches courses in Management Accounting and Analisis of Financial Statements (undergraduate studies) as well as Policy of Income and Strategic Controlling (master studies) and Advanced Management Accounting and Corporate Governance (doctoral studies). He also teaches Management Accounting in International master courses Management and Business Economy. So far he has published two books: Policy of Company's Income and Divisional Accounting. He is co-author of university textbook Management Accounting. Moreover, he has published numerous scientific and research papers in the fields of management accounting, corporate finance and financial reporting.

He is a member of Accounting Board in Association of Accountants and Auditors of Serbia, Board Executives of Serbian Association of Economists, Editorial Board of SAE Journal of Business Economics and Management. He is a certified public accountant.

Since 2004 to 2011 he was a member of Securities Commission, Republic of Serbia.

Vlade Milićević

is an associate professor at the Faculty of Economics, University of Belgrade. He has been teaching Management Accounting on undergraduate studies. Furthermore, he is the lecturer of Strategic Controlling and Profit Policy on master studies and Management Accounting II and Strategic Management Accounting on PhD studies. Additionally, professor Milicevic has been engaged as the vice-dean for finance and organization at the Faculty since May 2006.

Professor Milicevic is known as the author of books Cost Accounting and Business Decision Making and Strategic Management Accounting, and as the co-author of books Management Accounting and Financial Markets. Furthermore, he has written numerous articles related to accounting, financial management and auditing, as well as some outstanding papers for several conferences in that field.