UDC 338

DERIVATIVES IN THE REPUBLIC OF BELARUS: OPPORTUNITIES AND CHALLENGES FOR NON-FINANCIAL ORGANIZATIONS

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The article deals with the directions of application derivatives in the non-financial organization. The factors constraining the use of derivatives by non-financial organizations in the Republic of Belarus have been considered.

Introduction. In many cases derivative financial instruments may be interesting for the non-financial organizations, for which transactions in the exchange and OTC (over-the-counter) financial markets can't be referred as the main activity. The specificity of a derivative market may be described in the following way: the risk of price changes of underlying asset is traded here, while the underlying remains unaffected. Demand is formed by hedgers, who are interested in obtaining stable and predictable cash flows in the future and try to protect (hedge) the value of their assets, which depends on the movement of market variables (accordingly, hedgers are interested in transferring market risk to a third party). On the other hand, hedge funds and professional traders are ready to take risks in order to profit from short-term fluctuations in market variables on the basis of complex technical and fundamental analysis [5].

If the current activity of a non-financial organization isn't exposed to changes in market variables (commodity prices, exchange rates, interest rates, etc.), the organization may consider the derivatives market as a source of additional income, which involves the transformation of the financial department into a separate profit center. Otherwise, the company may be interested in applying hedging using derivatives. Thus, the sphere of derivatives has a potential reserve for improving the current activity of non-financial organizations, which is practically not used in Belarussian business-practice. The aim of this research is to consider and analyze opportunities and problematic aspects of derivatives application in non-financial companies.

The main part. As noted above, derivatives may be used for speculating or hedging purposes. It is very important to separate these two goals at the level of organization, because different systems of planning, organization and control of relevant transactions should be used for hedging and speculation.

Initially, in our opinion, it is necessary to consider the sphere of generating speculative income with derivatives. It is obvious that, in the presence of available funds and sufficient competence of the financial department, organizations of any industry will be interested in obtaining additional income in the derivative market (provided that the yield on speculative operations will exceed the yield on risk-free investments). From our point of view, the most significant aspect here is the fact that the finance department in this case becomes an independent profit center in the organization. In ordinary circumstances a finance department executes functions that ensures the normal operation of the enterprise, namely it has to [3]:

– develop financial and credit plans;
– make payments to customers;
– perform economic work aimed at improving the efficiency of production;
– monitor the implementation of long-term financial forecasts and financial plans, rational use of production resources, compliance with financial discipline;
– analyze financial and economic activity of the enterprise through systematic analysis of accounting, statistical and operational reporting.

But if persons responsible for corporate management have decided to allow the structural unit to work in the derivative market for getting additional income, it is necessary to separate this department from those, which aren't aimed at generating profit itself. It is necessary to protect managers from the temptation to carry out risky transactions without proper risk management procedures. When managers know that they are limited in certain money amount for speculative operations, all transactions are controlled by an independent structural unit and there is a clear bonus system for conducting profitable trading operations, in this terms we can say that obtaining speculative income in the derivatives market has a chance to be successful. Otherwise, it is better to invest in risk-free assets.

On the other hand, derivatives may be interesting to non-financial companies in the context of risk reduction through hedging. As noted above, hedgers seek to pass unacceptable risks to a third party (speculators) for a fee. This process is similar to the classical insurance scheme, but hedging risks are primarily related to market variables and related cash flows.

As noted by Stulz (2013) " ... quite often losses on derivatives with well-thought-out hedging are considered as a failure in the risk management system. Although the company applies hedging because it cannot predict what result will bring the asset, liability or future cash flow that is exposed to market risk in the future. And to avoid this uncertainty, organizations resort to hedging, while if the market movement is favorable for the company, then the hedging instrument will have an offsetting loss" [1].

In other words it is impossible to consider hedging only from the position of profit or loss on the hedging instrument (derivative), it is also necessary to take into account the change in the value of the hedged item. Since the value of the hedged item and the hedging instrument in an effectively constructed risk management system should move in opposite directions and provide the company with a stable level of income with a high probability [5].

In theory hedging can have a positive impact on the company's operations by directly increasing profits or by ensuring stable operating activity. Let's consider how these statements are consistent with the practice of non-financial organizations. For example, the Bodnar study (2011) provides information on the objectives of the risk management strategy. Thus, for 705 companies in the non-financial sector around the world, the main objectives are to increase the expected future cash flows; avoiding large losses from unpredictable price changes; increase in the value of the company [9, p. 48]. The objectives of risk management are presented in more details in figure 1.

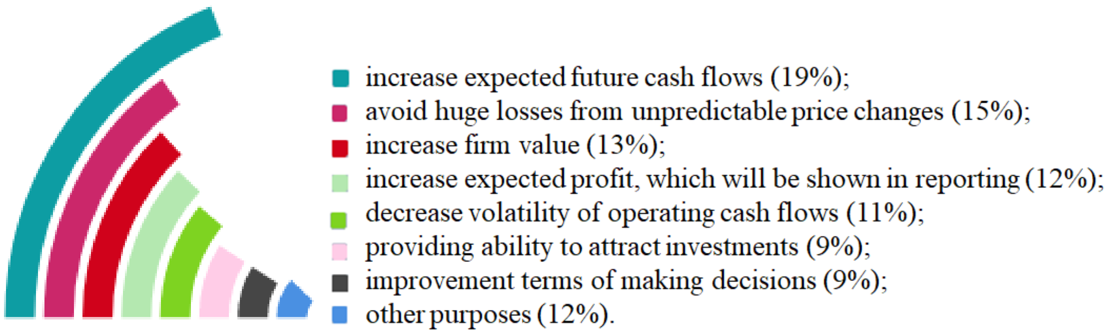

Figure 1.– Risk management objectives for non-financial companies worldwide

Source: [9, p. 48].

It should be noted that the achievement of these goals can be provided both with the application of hedging using derivatives and with the help of operational hedging (for example, when costs and revenues are denominated in one foreign currency) or other methods of risk management. Choice of a specific risk-management instrument in general depends on the specifics of the company's activity.

As noted by Bodnar (2011) 71% of companies from the extractive sector of the economy, 67% of the manufacturing sector and 46% from the service sector use derivatives in their risk management strategy [9, p. 49].

Also it is necessary to understand that the process of hedging is quite complex and requires consideration of various factors. This complexity is caused by the fact that hedging instruments are derivatives, such as forwards, futures, options or swaps. The Bodnar study (2011) provides information on the reasons for the refusal in the number of companies derivatives usage (respondents could choose several reasons). The results are shown in figure 2.

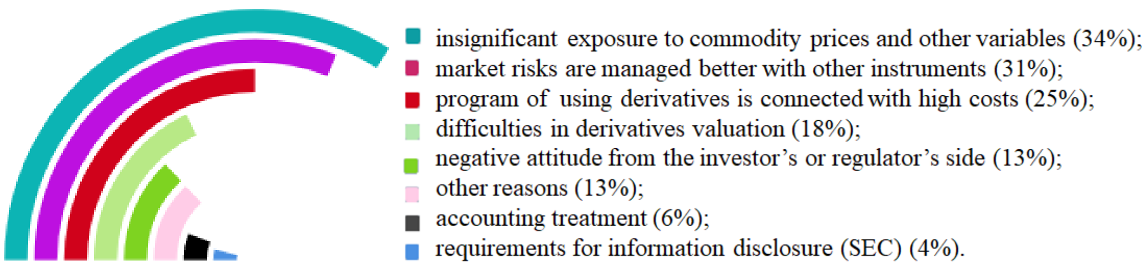

Figure 2. – Reasons for rejection from derivatives in risk-management strategy

Source: [9, p. 50].

The first three reasons from this rating can be attributed to the main reasons for the refusal to use derivatives, and they depend mainly on the specifics of the company's activity. If we turn to the Republic of Belarus, such authors as Sidorenko [7], Demidenko [4], Usefulchek [8] agree that the obstacles to the development of hedging institution in the country are the imperfection of the accounting and taxation in this area, difficulties in developing hedging strategy itself, underdevelopment of derivatives exchange and OTC markets, low level of corporate risk management in this area. Let's consider these problematic aspects in more detail.

Despite the introduction of international financial reporting standards (IFRS) as technical regulations on the territory of Belarus since January 1, 2017 the national system of accounting and reporting in the field of derivatives still doesn't provide a clear accounting of these instruments, therefore, doesn't facilitate the receipt by users of reporting relevant information on the opened market positions [6]. Despite the introduction of the National standard "Financial instruments" from January 1, 2019, certain significant aspects related to the use of derivatives in the practice of business entities remain unsolved. For example, based on the definition of a financial instrument it is necessary to include not only futures, forwards, options, swaps, but also ordinary contracts for the supply of goods in the future, the price of which is related to market variables (oil quotes, for example), respectively, to revalue them according to paragraph 15.2 and paragraph 18.2. For comparison IFRS 9 "Financial instruments" unambiguously defines that ordinary contracts for future delivery are not within the scope of IFRS 9. Also, organizations that used IAS 39 "Financial instruments: recognition and evaluation", which is taken as the basis of the Belarusian standard, note that accounting for this standard is more difficult than under the rules of IFRS 9, as a result in near future it will be necessary to change National standard according to IFRS 9.

Secondly, the regulation of transactions with derivative financial instruments in the field of taxation in the Republic of Belarus affects the value added tax and income tax, applicable only to banks, and income tax for individuals. In the taxation of income of non-financial organizations there is no any features related to income tax. At the same time, it can be noted that in the Republic of Kazakhstan, in Russian Federation and in the United Kingdom the legislation, governing the calculation and payment of income tax to a greater or lesser extent defines the features of transactions with derivative financial instruments, including those used for hedging.

Thirdly, from the point of view of civil law, nowadays operations with net-settled derivatives can be qualified as wager transactions, judicial protection for which is not provided. For comparison, in the Russian Federation this gap was eliminated in 2010 by the introduction of the corresponding norm in the Civil code of the Russian Federation (paragraph 2, article 1062).

With regard to the implementation of the hedging transactions themselves, we note that the issue is more concerned with the OTC market, because on the exchanges the contracts of the futures market section are standardized and there are well-established mechanisms for ensuring the fulfillment of obligations. Complexity can be caused by OTC contracts, where there is more flexibility, however, can be disputable moments concerning the order of calculations, determining the prices and terms of collection the debt from the defaulter. The best way to protect against disagreements in this case will be to prescribe all significant aspect in the contract, while the reference rules are better to change for full-fledged formulations, which will help to better understand the essence of the transaction.

Fourthly, the Belarusian authors name the low level of corporate risk management as one of the reasons for the underdevelopment of derivatives market. It should be noted that it is rather difficult to assess this level, especially within the country; therefore, here we should speak about the fact that the management of non-financial organizations of the Republic of Belarus is focused on solving critical issues related to current activities. While reducing exposure to non-core commodity or currency risks through hedging may improve the efficiency of an organization, but it is not a critical aspect of their operations. No doubts that if there is a clear in implementation and well-understood in possible benefits hedging strategy, every manager won't refuse to use derivatives, but so far everything remains very confusing

Conclusions and directions for further research: solution of named problems will allow the economy to distribute risks between economic agents more effectively. In our opinion, one of the possible approaches here is to consider in detail possible hedging strategies for major players or large groups of the non-financial sector of the Republic of Belarus. In specific examples should be included following questions: the order of reflection in the accounting of hedging operations, tax consequences, the effect for a particular organization, as well as management aspects – especially the planning, organization and control of hedging operations at the corporate level. The combination of such example-strategies will provide understanding benefits from hedging both at the macro and micro levels.

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