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*Economic analysis of internal and external risks  
from the positions of the theories of the market economy*

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Analiza ekonomiczna ryzyk wewnętrznych i zewnętrznych z perspektywy teorii gospodarki rynkowej

**Key words:** economic analysis, internal risks, external risks, theories, market economy, synergetic effects, risks theory

**Słowa kluczowe:** analiza ekonomiczna, zagrożenia wewnętrzne, zagrożenia zewnętrzne, teorie, gospodarka rynkowa, efekt synergii, teoria ryzyka

## **Introduction**

The current market environment is characterized by a continuing increase of uncertainty, elements of chaos. This applies to all entities and systems of their management. Therefore, these processes did not pass the service subsystems for management system – Accounting, Analysis and Audit. Thus, it is over time the many-sided studying of the possibility of minimizing uncertainty, the estimation of risk level and insurance from different types of risks – including economic for these subsystems.

Traditionally, the researches of native and foreign scholars are focused on risk analysis in risk management system, investment and financial management. One of the important issues researched by scientists-auditors is risk-based audit, audit risk and methods of it estimation. However, almost unidentified are the systemic risks relating to accounting, analysis and audit, while in the financial risk management risk events (business risk) include the accounting risks. Also for today the theories of the market economy in relation to economic analysis were not studied.

## 1. Risks theory and economic analysis

Risk – is the potential negative consequences of actions. That is, the probability of usefulness loss of any act or administrative decision to the interested persons. There are several interpretations of the “risk” concept that have developed historically and are continually improving.

Thus in the classical theory of risk (19th century) formulated by N. Senior and J. Mill, the risk was associated with the need of damage compensation as a result of business activity [N. Senior, 1854; J. Mill, 1909]. This is related to the then dominant idea of resources exhaustion, including law of diminishing returns of earth by T. Malthus and D. Ricardo.

Later, however, with the development of economic thought and its strengthening by mathematical instruments the risk started to be considered through the prism of utility achieving and profit maximization.

So in neoclassical theory of A. Marshall and A. Pigou the risk is considered from the point of marginal utility, particularly taking into account the size of the expected revenue and the dimension of its potential fluctuations at transacting [A. Marshall, 1920].

J. von Neumann and O. Morgenstern in their work “Theory of games and economic behavior” (1944) formulated the theory of expected utility, which states that a rational individual, choosing the most desirable of risky alternatives, seeks to maximize the expected value of the utility function [J. Neumann, O. Morgenstern, 1953].

Alan Willet in his “Economic Theory of Risk and Insurance” (1901) first attempted to highlight the economic aspect of risk in terms of uncertainty. He considered that “risk and uncertainty are the objective and subjective aspects of apparent variability in the course of natural events” [A. Willett, 1901].

The first scientific attempt of delimitation of the concepts of risk and uncertainty was the work of one of the neoclassical representatives, the American economist Frank Knight – “Risk, uncertainty, and profit” (1921). In it he states that risk is just such uncertainty, which can be technically evaluated and measured. This conception became the first step in the financial risk modern theory development, the main purpose of which is optimization of risk function [F. Knight, 1921].

Proponents of the institutional branch advanced a completely new vision of the nature of risk. They considered that risk is the possibility of deviation from the goal for which a particular administrative decision was taken [M.M. Aleksandrova, K.K. Ullubieva, 2009]. The position of Schumpeter is typical in this matter. In his book “The theory of economic development. An inquiry into profits, capital, credit, interest, and the business cycle” (1934), he insisted on the necessity of considering by an economic entity that, if the risks are not captured in management plan, then they are on one hand damage, on the other – the profits source [J. Shumpeter, 2004]. So you can make a decision that has less risk, but less the obtained profit will be.

Neoinstitutional risk theory proposed by famous economists Harry Max Markowitz and William Forsyth Sharpe. H. Markowitz idea is that the financial markets have two

objectives: first, increasing the expected revenue, and secondly, reducing the risk by revenue uncertainty degree. It is suggested that H. Markowitz proposed to consider as the risk level indicator the deviation of random variable expected value (profit) from its mean value – variance and standard deviation. The principal contribution to the theory of risk by Sharpe was the distribution of total risk into two conditional parts: systematic risk as a result of general economic shifts and specific – as a result of separate enterprise economic activity [L. Romanenko, A. Korotaeva, p. 122].

As to quantified economic risk, prof. V.V. Vitlinskiy and H.I. Velykoivanenko believe that measurable properties of economic systems should include such characteristics of the structure, condition, dynamics or behavior of the of these systems and their environment that make it possible in the face of uncertainty and conflict to find and to detail for the potential effects the possible future states or certain economic facilities behavior trajectory of possible deviations from the goals, potential losses and unused opportunities. Detection of such properties is the subject of qualitative and quantitative risk analysis and lies in the identification of key variables (risk factors) and the structuring of shapes, forms and types of risk [V.V. Vitlinskiy, G.I. Velykoivanenko, 2003, pp. 16–21].

In turn, the economic risk is such a type of risk that arises in any kind of business directed on getting profit and related to the products production, goods sale, services provision, performance of works, trade – cash and financial transactions; commerce, as well as the implementation of scientific – technical projects [A. Lobanov, A. Chugunov, 2003, p. 10].

If we take this interpretation, as a basis the economic risks in analysis are caused by the fact that it (analysis) is a management system information resource, it forms the information field around every economic phenomenon, process, activity, type of relationship, resources, etc, which can be varied used depending on the needs of stakeholders. In this regard it is no accident that a number of economic sciences and practices use the analysis being a tool to reduce the substandard information risks as one of the researching methods. For example, analytical audit procedures are performed, according to A.P. Sheremet and V.P. Suyts [A.P. Sheremet, V.P. Suyts, 2001, p. 166], in order to detect unusual and incorrect reflected in accounting of economic activity, as well as establishing the causes of these errors and distortions.

Economic risks are divided into: operational (commercial and industrial), financial (interest rate, credit, foreign exchange), investment (investment, innovation). In our view, a clear identification and traceability of the nature and extent of the economic risks impact on individual aspects and activities of the enterprise is impossible because they directly or indirectly have an effect on the operating, investing and financing activities and, consequently, on the behavior of costs, revenues, capital, liabilities, assets and cash flows. Therefore, it is necessary to consider economic risks as transformed into reducing benefits, increasing losses. The main consequence of the economic risks associated with the analysis is negative dynamics of the enterprise activity indicators.

## **2. Systemic risks of economic analysis**

For the economic analysis in the 21st century it is characterized by systemic risk – the possibility of its utility losing by:

- institutional and structural risks;
- the lack of balance between supply and demand for analytical information;
- the existence of political cycles in the economy;
- the high level of government regulation;
- the lack of qualified analysts availability;
- the lack of material incentives for such labor-intensive and responsible work as an analytical;
- financial factors;
- motivational factors;
- accounting systemic risk.

Today in Ukraine are only a few guidelines related to economic analysis. Almost all of them are associated only with financial analysis and does not take into account possible technical – economic, management, innovation and other types of analysis.

The synergistic effect on the economic analysis risk also has the inadequate legislation in the accounting field, the mismatch of financial accounting regulations and tax laws, or conscious inability to follow the Law of Ukraine “On Accounting and Financial Reporting in Ukraine” (as amended) because of interests conflict.

In Ukraine, at the macro level the analytical work is carried by administration, departments of ministries and agencies. The Ministry of Finance of Ukraine established The Methodological Council on Accounting, while the issue of economic analysis methodology were dropped of it sight.

## **3. The behavior of the analytical information demand at risk-oriented environment**

The behavior of the demand on the certain economic analysis types that have a price (cost measure) will depend on:

- the demand and supply on related (substitution) economic analysis types that perform similar or the same functions;
- the market capacity and structure, where analytical services are offered;
- the analytical services prices – they will increase according to the growth of complexity and amount of analytical work;
- the level of business – the higher is the proportion of medium and large businesses in Ukraine, the greater is the need of economic analysis;
- the frequency of need of the economic analysis carrying.

Another display of the lack of balance between economic analysis information products supply and demand is a situation of supplying on the background of post-

poned demand. This issue was discussed in November 2003 at the “round table” of Razumkov Center “Non-governmental analytical centers in Ukraine: supply and demand.” It was noted that there is no relay on the executive vertical of steady demand on the analytical products of the third sector. There is observed the improper use of analytical products on macro level by not subjects of management, and other stakeholders, as its main users are:

- the political parties;
- the research and educational institutions;
- foreign governmental and non-governmental organizations;
- community organizations [V. Chaliy, M. Mashkov, 2004, p. 4].

Most analysis agencies or administrations are centered on ministries, departments, regional bodies of executive power, bank sphere and investment companies, namely on the area of significant financial flows, where the risk level of inefficient management solutions depends on the quality of analytical data.

The economic analysis risk “weight” in management system increases significantly due to the risks synergy effect associated with accounting – accounting risks increase the negative effects of economic analysis as a management system data base.

## Conclusions

Consequently, the carried out research indicates that the internal and external environment of economic analysis is characterized by many negative acting factors that contribute the relevant risks realization.

The reducing or elimination of identified negative economic analysis environmental factors through their monitoring will enhance the competitiveness of analytical services, improve the economic analysis functional characteristics level and, therefore, will contribute the growth of owners, managers and other stakeholders economic benefits.

The solution of above outlined problems associated with the economic analysis risk as a scientific and practical activity should be linked primarily to the strengthening of analytical studies executor moral and material motivation; regulation of economic analysis by using the evidence-based analysis methods from the state institutions; further harmonization of Ukrainian legislation; the engagement of market regulation mechanisms of economic analysis demand and supply; the awareness of economic analysis necessity to reduce the uncertainty and risk in decision-making.

Urgent in view of the trends and prospects of economic analysis development in the 21st century is the conclusion that the economic analysis faces with many problems. First of all, a single system of economic analysis needs to be created. The providing of individual, community and national needs in economic analysis in Ukraine can be reached if the risks of external and internal environment are neutralized and minimized.

The 21 st century, current political, socio-economic, and ecological trends will require further improvement of existing methodology and the organization of economic

analysis that would take into account both the dominant concepts and alternative directions of economic analysis.

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### **Economic analysis of internal and external risks from the positions of the theories of the market economy**

Economic analysis in the information economy has a great importance as part of the public and business owners interests harmonization. However, in a market economy, there are some internal and external environment risks that influence on the effectiveness of analytical information. When identifying the main economic analysis risks it should be taken into account the basic tenets of the theories of the market economy. The development of neutralizing the economic analysis risk it must also be taken into account the synergy effects action.

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Rola analizy ekonomicznej w gospodarce opartej na informacji jest ogromna, szczególnie w zakresie harmonizacji interesów właścicieli kapitału oraz pozostałej części społeczeństwa. W gospodarce rynkowej występuje jednak wewnętrzne i zewnętrzne ryzyko, które wpływa na efektywność prowadzonych analiz. W momencie zidentyfikowania określonego ryzyka należy je uwzględnić, wykorzystując podstawowe założenia teorii gospodarki rynkowej. W działaniach zmierzających do eliminacji wpływu ryzyka na wyniki prowadzonych analiz należy wziąć pod uwagę występowanie efektu synergii.