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April 2007

Online at <https://mpra.ub.uni-muenchen.de/11438/>
MPRA Paper No. 11438, posted 15 Nov 2008 03:58 UTC

CONSOLIDATION OF THE FINANCING DECISION ON THE MICROECONOMIC LEVEL

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The determination of financial structure represents an important decision within the domain of financial policy of the enterprise aiming to the combination of used resources on a reduction background relating to the financing costs. The financing decision shall not entirely depend on the enterprise, its objectives, its anticipated profitability or the risks it consents to bear, but it shall be influenced by shareholders, banks, state, and the way in which the economic mechanisms are functioning at the regional, national and global level.

The economic and political situation recorded in Romania in the period following the year 1990 affected the economic and financial relations of Romanian enterprises.

Within the essay, there are distinguished issues relating to the importance of the choosing decision for the enterprise financial structure, as well as the need for the strengthening of the financing decision within the train of events displayed by the market it acts on. A series of factors regarding the environment such as the inflation, the monetary policy, the exchange rate, the fiscality degree, and so on, exerted notable influences on the financing decision on the microeconomic level.

Key words:

**the financing decision on the microeconomic level;
the profitability criterion and the resources designation criterion;
influence of the inflation rate, interest rate and the exchange rate.**

The progress of every activity implies the existence of a capital. As a rule, the companies could embrace different financing modalities depending on the organization pattern, the capability to obtain overflows from the service operations involved, on the influence exhibited by the shareholders, the policy exercised by the debtees, the economic environment where it acts but also on the financing cost related to every source.

An important issue that rises before the company while adopting the financial decision is consequently represented by the optimum combination of the financial means, that is the preference for a financial structure which allows the financing of all necessities within the reduction background of the financing costs.

The determination of financial structure represents an important decision which penetrates into the financial policy domain of the company. It has to establish the modality for achieving the financing aspects by employing the short-term debts or permanent capitals and, moreover, through the determination of the balance between own capitals and those lent on a medium-term and long-term. The usage of own capitals for activity financing has been, for a long time, considered as the most profitable modality for ensuring the corresponding financial resources. But, taking into account the permanent increase of financing needs that could not be covered by repeated issuances and the requirements enunciated by the shareholders, in the sense of the enlargement of remuneration level for the

invested capitals, the tendency to appeal to short-term lent capitals has been widely noticed at the level of Romanian companies. Within short-term debts one distinguishes operating debts, the credit line appreciated by the providers managers as an important financing source, because of its non-onerous title (although its widely spread usage could lead to financial blocking), as well as financial debts.

But appealing to indebtment generates compulsoriness for the reimbursement of the lent amounts of money and its related interests, which could engender the insolvency risk. The choice for financing by indebtment or by own capitals influences the balance risk/profitability. Thus, the indebtment financing could determine the increase of profitability but also the augmentation of the risk. Certain criteria could be used while embracing the financial structure, among which the most important are the profitability and resources designation criterion.

The profitability criterion is based on the reasoning according to which a profitable company (its profitability rate exceeds its interest rate) should not expect until the accumulation of its own funds in order to finance a project but the company could very well resort to credits. Although both own capital and lent capital imply the existence of costs, there is an essential difference between the cost of own capital and the cost of the lent one. It consists in the fact that own funds are not remunerated unless the company obtains some profit, while the lent capital should be remunerated no matter the company's profitability. A company engendering large debts shall register on a monthly or systematic basis, higher financial expenditures decreasing the possibility for ownfinancing.

Under such conditions, the profitability criterion is decisive, consequently, if the company is profitable, that is the rate of economic profitability (r_e) is predominant over the interest rate (r_d) then it could resort to credits. The decider has to follow the indebtment effect which is established by comparing the economic profitability and the cost of lent capital (reflected within the interest rate):

$r_e > r_d \Rightarrow$ positive or favourable indebtment effect

$r_e < r_d \Rightarrow$ negative or unfavourable indebtment effect

The importance of the financial structure of an enterprise results from the influence of lending on the own funds profitability also known as the levier effect, from the acquiring of enterprise autonomy and the risk determined by the contraction. The levier effect could be define as the mechanism by which the indebtment influences the financial profitability, the profitability expressed by relating profits, as results of the operation and own funds.

The financial profitability is directly proportional with the financial structure represented by the relation debts/own funds and the difference between the economic profitability and the interest rate:

$$r_f = r_e + \frac{D}{K_{pr}}(r_e - r_d) \quad (1)$$

Taking into account the proceeding for the calculation of financial profitability, one could estimate that it equals the economic profitability ($r_f = r_e$) when debts are null. If the economic profitability is higher than the interest rate ($r_e > r_d$) it results that the indebtment

effect is positive and, in consequence, the financing through credits is advisable. If the economic profitability is lower than the interest rate ($r_e < r_d$) one could estimate that the indebtedment effect is negative and implicitly the financing through credits is not advisable.

In compliance with the second criterion used for the assessment of the financial structure, namely the resources designation criterion, the fixed assets (A_i), which includes the needs bearing a permanent character, should be financed out of invested or long-term capitals, as it might be riskful to finance the purchase of fixed assets from financial resources with on-coming maturity. The current assets (A_c) could be covered by the working capital but also by short-term debts due to the settled feature of a part of the current assets, as well as the high fluctuations recorded subsequent to a change within the provision, production and commercialization conditions. Consequently, between resources and usages the following relations could be established:

$$A_c = FR + Dts \quad (2)$$

where: A_c represents the current assets (expenditure consumed during the operating cycle); FR – the working capital; Dts – short-term debts.

$$FR = Cp - A_i \quad (3)$$

or:

$$FR = Cp - A_i \quad (4)$$

where: Cp represents the long-term capital which integrates all long-term financing sources, which means the equity ownership and financial debts (credits) on medium and long-term, as follows:

$$Cp = Kpr + Dtml \quad (5)$$

where: $Dtml$ represents the medium and long-term debts.

Importance is displayed for the company by adopting the financing decisions in compliance with the permanent or temporary character of financing necessities. These decisions involving financial policy are supported by the financial structure embraced by the company depending on certain criteria. Consequently, one could state that the main responsibilities of financial policy consist in the selection of the right balance for increasing the economic capital, as well as of the modalities for financial covering.

The financial structure is not only influenced by the capital cost, the relation profitability-risk, the manager's choice or the old shareholders' adopted position. A series of economic and financial factors affects it, such as the sales dynamics, the economic and financial profitability, the internal conditions and the profit level.

Also, the financing acitivity is influenced by the functioning of macroeconomic mechanisms and implicitly, of their corresponding factors (inflation rate, interest rate and the exchange rate).

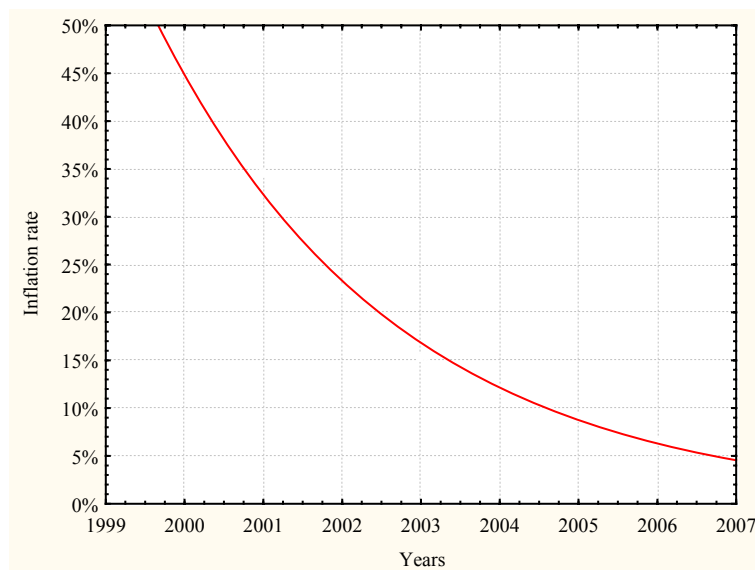
One could state that in Romania, with reference to the period 2000-2006, the inflation impact on the economic activity developed at the microeconomic level has been reduced, compared to the situation recorded soon after the 90's when inflation constituted a

permanent reality which oppressed the Romanian economy (especially during the period 1991-1994 and the year 1997 when hyperinflation has been recorded, and this extremely high monetary phenomenon had not been encountered during 2000-2006, according to official data):

Table no. 1

Inflation rate in Romania	
Year	Annual inflation rate -%-
2000	45,7
2001	34,5
2002	22,5
2003	15,3
2004	11,9
2005	9,0
2006	6,56

Graphically, the evolution of the inflation rate is represented as follows:



One could notice that the inflation decreased from 45,7% in 2000 to 6,56% in 2006, and 2005 has been the first year following the period after 1990, when the inflation was represented by one digit, confirming the disinflationary trend during the recent years.

We have to specify that, for every business enterprise that operates within an inflationary environment, it is difficult to maintain its position but particularly to develop due to the fact that determined policies could not be achieved in time and thus, the accomplishment of a real positive profitability becomes almost impossible to reach.

The disturbance of the inflationary phenomenon from a period to the other, as it results from table 1, represents, in fact, one of the reasons for which numerous enterprises

have not been able to adjust to economic conditions and thus, they registered negative values for the real profitability. But, as the creditors bear the capacity to estimate negative real financial profitability rates, the companies shall be certainly directed towards other investment opportunities, and implicitly towards the indebtedment procedures in order to finance the investments or even for being able to further proceed their activity under certain difficult circumstances from a financial point of view.

As it has been stated earlier, alongside with the inflation rate, the interest rate on the market represents another useful indicator both for the enterprise and its investors, for at least two reasons:

1. the shareholders constantly compare the profitability rate displayed by the enterprise out of its own activity developed by means of deposit interest rate, and if the latter cannot offer a higher profitability than the one obtained by capitalizing under the form of bank investment, this could mean the loss of financing out of equity ownership;
2. in the case of indebted companies, the interest rate determines the cost of debts which directly influences the weighted average capital cost.

Between the inflation and interest rate, there is an interconditioning relation, one could state, because the inflation rate unfavourably influences the interest rates.

As far as the exchange currency is concerned, and its influence on the activity developed at the microeconomic level and implicitly, on the financing sources for these activities, this is affected by the recorded fluctuations, as follows:

Table no. 2

**Currency RON/EUR and RON/USD
At the end of the period**

Year	Currency EUR	Currency USD
2000	2,40076	2,588
2001	2,7727	3,1428
2002	3,4919	3,35
2003	4,0994	3,2798
2004	3,9378	2,8941
2005	3,6908	3,116
2006	3,3982	2,5859

Beginning by the year 2000 RNB has replaced the reference currency (USA dollar) by a mixture of currency composed of 60% EURO and 40% USD, these balances being justified at the moment by the importance of the two exchange rates within the exterior exportation Romanian commerce and financial transactions; subsequently, the year 2004 brought a change in currencies to 75% EURO and 25% USD, and the reference currency for the year 2005 shall become EURO.

In compliance with the average-term economic strategy elaborated by the Government and RNB, the exchange rate has been used at the beginning of 2000, more as an antiinflationary anchor and less as an instrument for adjusting the external imbalances, the transmission channel of the monetary policy through the exchange rate towards the inflation has proved very efficient.

If until the end of 2003, the Romanian Leu has experienced a depreciation as compared to the European currency and the American dollar as it results from table 3, the

beginning of the 2004 has faced a change within the strategy for the RNB exchange rate. The currency has become more flexible. The National Bank has interceded on the currency market less frequently and less predictably, and thus the exchange rate RON/EUR appreciated. The exchange rate appreciation has been largely due to an appreciation trend existing on the currency market because of the liberalization of the capital account already announced since April 2005 and the expectation for high capital inflows due to increased currency differential between Leu and other currencies. Also, the flexibility of the exchange rate of the national currency has been imperatively necessary for the inflation aimed strategy, implemented by RNB since August 2005. This strategy of monetary policy implies, as an essential condition, the existence of an exchange rate with free flotation.

The depreciation of Leu during the anterior period (until 2003) has influenced the financial structure through the net result between export and import, and further on it had a certain impact on the net results within all operational domains, because the prices of raw materials and utilities are always adjusted as compared to the exchange rate.

For exporters and importers, the net financial result depends on the report between the financial revenues and the incurred expenditures, under the influence of a change within the exchange rate. The net financial result is determined dependent on the recording modality of differences in currency. If, for example, the exchange rate Leu-Euro is higher during the collection charge than during the moment of receivable right, a favourable exchange rate difference shall be registered, and an unfavourable exchange rate difference shall be encountered during a distinct situation.

The depreciation of Romanian Leu could also have a neutral influence or favourable one on the exporters profit due to charges to be accomplished, which might lead to an increase of own financing and implicitly a decrease of debts balance within total liabilities. But this situation is negatively reflected on the importers financial results who have paid in currency and who are thus, forced to pay more for the imports achieved in the past, paid under a depreciated national currency. Consequently, they are forced to increase the debts balance for total resources.

As a conclusion, one might notice that the selection of financial structure represents an important decision for the financial management, with profound implications within the operating domains at the level of business enterprises, being subject to the influence of a series of internal and external factors. Generally, we could state that the main financing source in Romania is constituted by own funds and then, the short-term debts in the detriment of long-term debts. This situation could be considered as a consequence of a defective management that cannot contract long-term credits, but also of the microeconomic circumstances and a crediting policy which encouraged the companies to resort to short-term credits (for example, resorting to long-term loans under the form of issuance of bonds is not a very common method used by Romanian enterprises). Under such context, the selection of financial structure should be made by taking into consideration of all micro but also macroeconomic variables.

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