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Oprean, Camelia

Faculty of Economic Sciences, University Lucian Blaga of Sibiu

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An Analyses of Romanian Companies' Financing Decisions under Macroeconomic Influences

*Oprean Camelia, PhD lecturer
Faculty of Economic Sciences,
University "Lucian Blaga" of Sibiu
camelia.oprean@ulbsibiu.ro*

Abstract

The highly important issue by which a company ensures its required capitals, both as volume, and as structure in due time and at low costs renders the financing decision an essential role in the administration and management process. Selecting the capital structure at company level implies both setting the extent of financing from own, respectively loaned resources, and considering the procurement costs of these resources.

The weak financing of Romanian companies is one of the major causes of the deficient use of the owned production resources, therefore financial resources at accessible costs become essential to the respective economic agents.

Considering that the financing decision may be influenced by the manner the economic mechanisms operate on national level, in this report, we emphasize that financing resources must not be analysed individually, but in relation to the macroeconomic variables, e.g. inflation or the interest rate on the market.

In order to see how the evolution of the interest rates have influenced the trend of loans granted by the loan establishments, this report represents a structural and dynamic analysis of the evolution of the overall loans with an emphasis on the non-governmental loans.

The swift transition to a new economic mechanism at the beginning of the 90s occurred as Romanian enterprises were completely unprepared, whilst the continuance of most companies was conditioned by non-payment of debts and accumulation of arrears. Therefore, the final part of this report deals with the arrears, a sensitive issue in Romanian economics.

Key words: financing decision, inflation, interest rates, loans, arrears

JEL classification: G3

In the process of substantiating the decisions to demand an external capital stream, including the contribution of the owners, the financial indicator of the capital cost regarded as an essential restriction becomes increasingly important. In the process of financing, companies use both own and loaned capital, equally representing a source of costs for companies. Optimization of capital structure is a profitable activity only if it is designed, organized and conducted properly. Thus, it is important to determine the amounts of these costs due to the following reasons:

- ◇ to optimize the activity, the costs must be as low as possible;
- ◇ to select the optimum company structure, namely the optimum rapport between own and loaned capitals.

The structure and average costs of the capital represent a source of profit for companies, thus this is a profit arising from this specific source and not originating from exploitation, from financial or exceptionally traditional sources. Consequently, the cost of capital must be predicted and the company must design an appropriate strategy and tactical procedures in order to attain this desiderate.

The cost of capital represents the profitability ratios required by capital bearers, either shareholders, or creditors, namely the cost of capital is the financial effort undertaken by the company in order to obtain capital. As a last resort, the capital is the minimum profitability obtained by the investors, which is able to guarantee a profit to shareholders comparable to the one obtained on the market on the same risk level. In any case, the cost of a finance source, either owned, or loaned capital, cannot be accepted unless it is below or equal to the profitability ratios required by the entrepreneur.

The **inflation** has been a permanent reality of the Romanian economy after 1990. The development of a company within an inflationist environment is more difficult because it prevents a political stability to be achieved in due time. During the first part of the aforementioned period (1994 – 1994 or the year 1997), the inflationist phenomenon has grown to huge dimensions (exceeding by far the value of 100%). During the past years, the target has been an inflation rate below 10%.

The **interest rate** of the economy has also been a reference indicator for companies. The indicator is useful in estimating the costs of debts, and also as reference for shareholders who will compare the company's profitability with the interest rate on deposits.

Table 1¹ displays the evolution of the interest rates offered by banks and of the inflation rate during the period 2001 – 2009 (jan.):

**Table 1. Medium interest rates offered by the loan institutions
(for operations in RON – non-bank non-governmental customers)**

Year	Average active interest (%)	Average passive interest (%)	Inflation rate (%) ²
2001	45,74	26,16	34,5
2002	36,65	18,39	22,5
2003	26,19	10,78	15,3
2004	25,81	11,34	11,9
2005	19,19	8,22	9,0
2006	13,90	6,51	6,56
2007	13,32	6,70	4,84
2008	15,29	9,93	7,85
2009 jan.	17,87	14,03	-

It is obvious that both the active and passive average interest rates, as well as the inflation rate have had a descending evolution during this period. It is only in 2004 and last 2 years that the interest rates (active and passive) covered the annual inflation rate, and only the active one during the rest of the years. Due to the negative financial profitability rates obtained from bank deposits, from the perspective of the Romanian investor and on average basis, the deposit of temporarily available funds into banks during this period was not an investment more attractive than the purchase of stock.

In order to see to what extent the interest rate and the inflation influenced the trend of loans granted by banks to non-financial companies and to the population, we shall use the data provided by the Romanian National Bank (BNR) in statistics³. In this concern, the non-governmental loan in Romania during 2004 – 2009 (January), short, medium and long term loans in RON have evolved as follows: (Table 2 and Figures 1, 2, 3):

**Table 2. The evolution of non-governmental loans in RON
(million RON; end of period)**

Year	Total	Short term			Medium term			Long term		
		Total	<i>of which</i>		Total	<i>of which</i>		Total	<i>of which</i>	
			Non-financial companies	Population households		Non-financial companies	Furnished to the population		Non-financial companies	Population households
2004	15683.4	7531.9	6264.2	870.1	7368.4	2021.6	5221.9	783.1	388.0	329.8
2005	27091.6	11379.0	9849.3	1361.5	10483.9	2952.1	7273.8	5228.7	1516.4	3312.9
2006	48637.3	17463.2	14920.1	2264.2	14015.3	5430.4	8233.4	17158.8	3500.9	12587.3
2007	67713.0	20804.4	16723.6	3327.0	19109.5	9378.4	9049.6	27799.1	6474.8	21196.2
2008	83672.3	25518.1	20570.4	4257.5	21797.7	11303.0	9765.6	36356.5	9072.4	26921.3
2009 Jan.	83767.6	26154.5	21180.1	4293.1	21653.7	11293.5	9620	35959.4	9027.4	26672.7

¹ Source: Annual BNR reports; monthly BNR bulletins No. 12/2005 (pg. 15); No. 12/2006; No. 1/2009 (pg. 62);

² Source: Data provided by the National Institute of Statistics, www.insse.ro

³ Source: BNR statistics sections, excerpts from monthly bulletins No. 12/2007 (pg. 31); No. 1/2009, www.bnro.ro

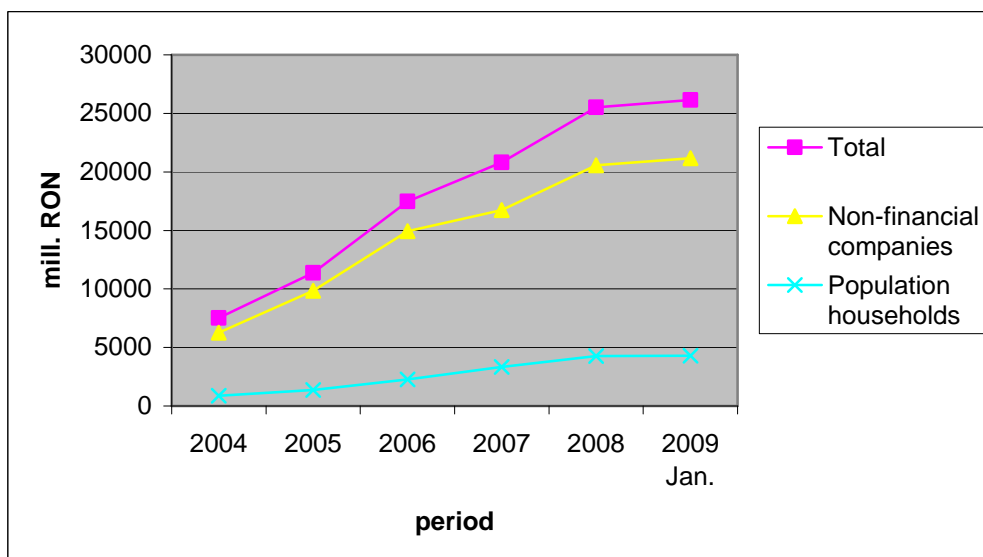


Figure 1. The evolution of non-governmental short-term loans in RON

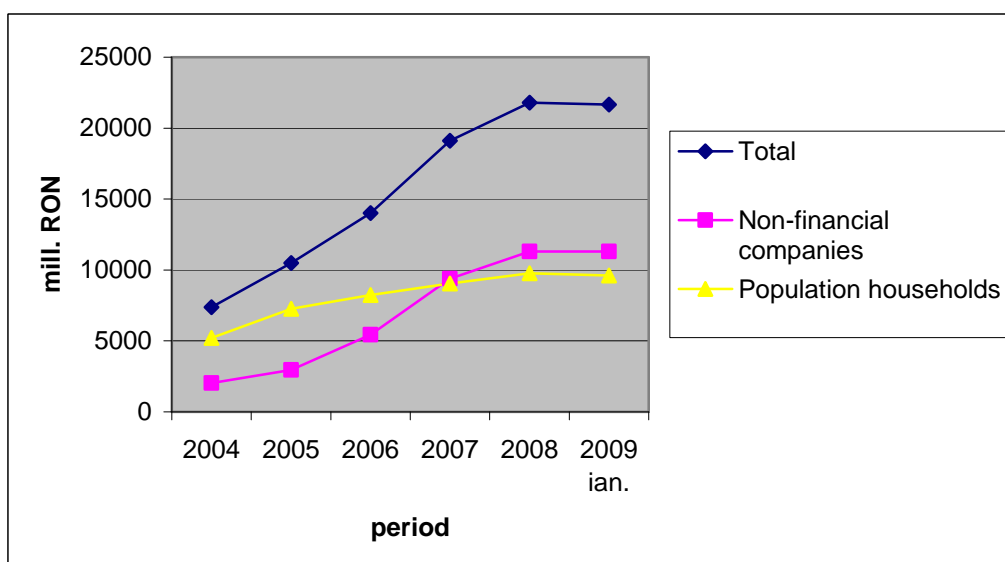


Figure 2. The evolution of non-governmental medium-term loans in RON

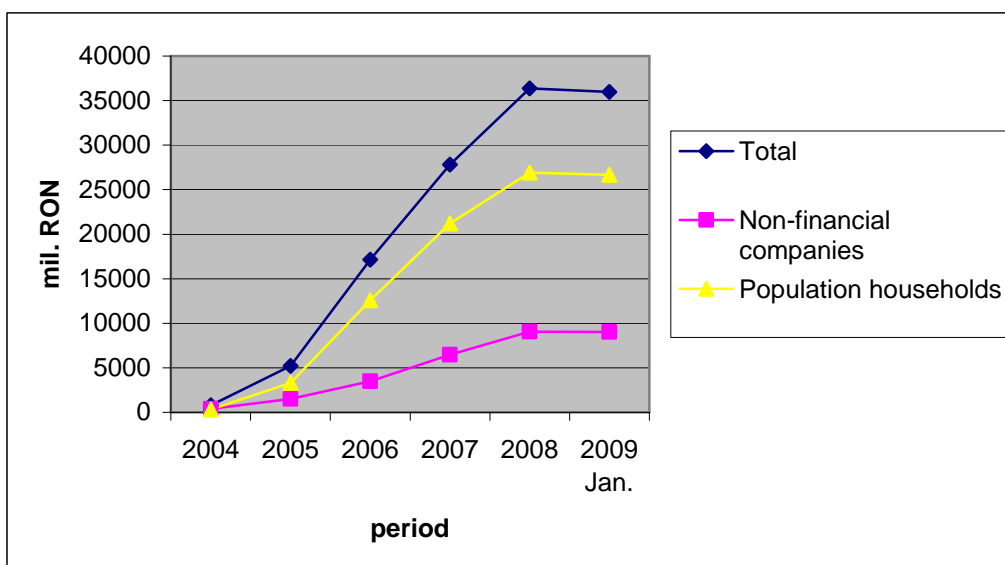


Figure 3. The evolution of non-governmental long-term loans in RON

The analysis of non-governmental loans in RON over the 2004 – Jan. 2009 period leads the following important conclusions:

◇ the yearly ascending evolution is clearly visible for loans granted in RON, especially after 2004 – following an analysis of the prior situation – and this evolution applies to all three types of the aforementioned loans. This fact may be interpreted as a sign of “recovery” of the Romanian economic environment;

◇ if the non-financial companies have benefited from the overwhelming majority of non-governmental short-term loans, the situation changes when referring to the long-term loans offered by banks to a greater extent to the population;

◇ from the structural perspective of loans obtained by non-financial companies, it is visible that these finance their exploitation activity mostly by means short-term loans, while the obtained long-term loans of these companies represent a lesser part from the total of loans.

We may also analyse the situation of loans furnished by loan establishments according to the beneficiaries’ form of property, which had the following evolution during 2004 – Jan. 2009 (Table 3 and Figure 4):

Table 3 – Loans furnished by loan institutions according to the beneficiaries’ form of property (million RON)⁴

Year	Total	Beneficiary’s form of property						
		Private	State owned	Mixed		Cooperative	Natural persons	Public
				Company with foreign capital	Company with private and Romanian state-owned capital			
2004	46918	35246	4629	1192	1003	81	4012	755
	100%	75.12%	9.87%	2.54%	2.14%	0.17%	8.55%	1.61%
2005	65577	46393	5885	1313	1284	95	10298	309
	100%	70.75%	8.97%	2.00%	1.96%	0.14%	15.70%	0.47%
2006	105271	69811	8463	957	1841	151	23561	487
	100%	66.32%	8.04%	0.91%	1.75%	0.14%	22.38%	0.46%
2007	167958	102330	10474	1594	1957	198	50566	839
	100%	60.93%	6.24%	0.95%	1.17%	0.12%	30.11%	0.50%
2008	228752	132781	12243	2370	2736	262	77491	870
	100%	58.05%	5.35%	1.04%	1.20%	0.11%	33.88%	0.38%
2009 (ian)	229948	133570	12251	2349	2767	279	77864	869
	100%	58.09%	5.33%	1.02%	1.20%	0.12%	33.87%	0.38%

⁴ Monthly bulletin issued by BNR No. 1/2007 and No. 1/2008

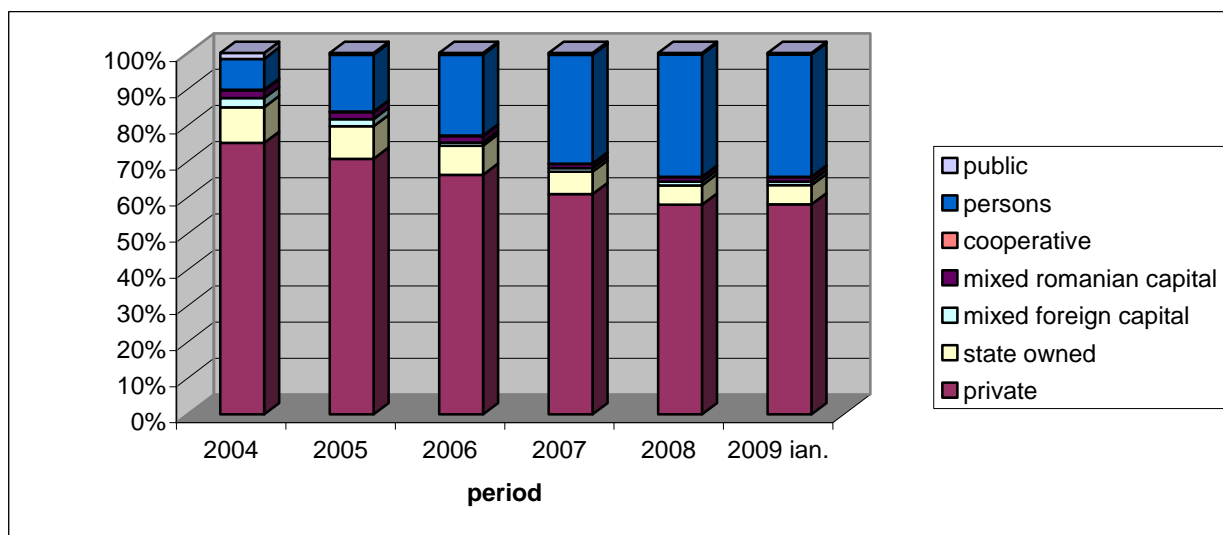


Figure 4 – Loans furnished by loan institutions according to the beneficiaries' form of property

It is obvious that the loans furnished by loan institutions were addressed especially to private beneficiaries. Therefore, the value of loans furnished to private economic agents exceeds by far the value of loans furnished to companies with state-owned capital (as expected).

The volume of loans furnished to private beneficiaries is ascending, from the structural point of view these are in total in a downward tendency in relation with the growth of loans obtained by natural persons. As far as the loan beneficiaries with state-owned capital, the loans in RON have had an almost constant evolution, slightly descending.

The structure of loans offered by loan institutions according to the activity sector of the beneficiary, Table 4 and Figure 5 indicate their evolution during the 2004 – Jan. 2009 period:

Table 4 – Loans furnished by loan institutions according to the beneficiaries' sector of activity (million RON)⁵

An	Total	Activity sector						
		Industry	Services	Constructions	Agriculture, forestry, pisciculture	Financial mediation and insurances	Public administration and defence, social insurance in the public system education, health and social assistance	Natural persons and personal households
2004	46918	17572	16704	2197	1160	2763	2510	4012
	100%	37.45%	35.60%	4.68%	2.47%	5.89%	5.35%	8.55%
2005	65577	19055	22226	3336	1518	4943	4202	10298
	100%	29.06%	33.89%	5.09%	2.31%	7.54%	6.41%	15.70%
2006	105271	25138	35072	6245	2770	6623	5862	23561
	100%	23.88%	33.32%	5.93%	2.63%	6.29%	5.57%	22.38%
2007	167958	32745	56480	9777	3783	6912	7696	50566
	100%	19.50%	33.63%	5.82%	2.25%	4.12%	4.58%	30.11%
2008	228752	41197	71740	16350	5428	8775	7773	77491
	100%	24.53%	42.71%	9.73%	3.23%	5.22%	4.63%	46.14%

⁵ Monthly bulletin issued by BNR No. 1/2008 and No. 1/2009

2009	229948	41172	71616	16533	5486	9489	7788	77864
ian.	100%	24.51%	42.64%	9.84%	3.27%	5.65%	4.64%	46.36%

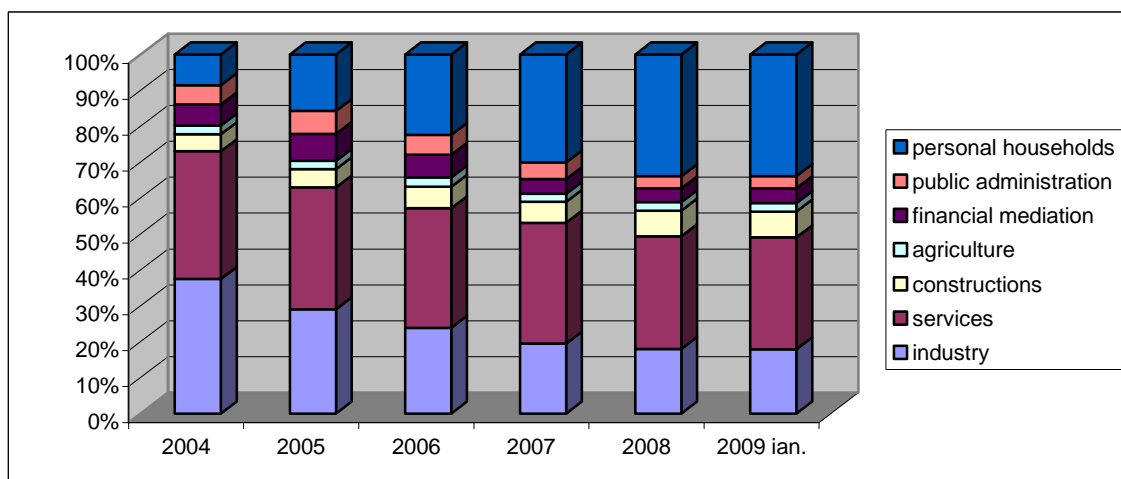


Figure 5. Loans furnished by loan institutions according to the beneficiaries' sector of activity

From the structural point of view and according to the aforementioned criterion, the service and industry sectors have had the largest percentages from the total of loans. As indicated by Figure 5, the situation changes from one year to another with the following tendencies:

- the percentage of loan beneficiaries from the service sector is relatively constant during this period;
- the percentage of the industrial sector indicates a descending tendency towards the analysed period;
- at the same time, the loan beneficiaries represented by natural persons is in a clear ascending tendency from one year to another, thus by 2008 and the first month of 2009, the percentage has grown to be more than the percentage of loan beneficiaries from the service sector. The evolution is obvious, if we consider that in 2004 the natural persons have benefited from 8.55% from the total of loans, by January 2009 this percentage has grown to 46.36% from the total of granted loans.

According to the granting criterion, the loans offered by loan institutions during the analysed period have had the following evolution, indicated in Table 5 and Figure 6 :

Table 5 – Loans provided by loan institutions according to the duration (million RON)⁶

Year	Short-term	Medium-term	Long-term
2004	19577	17904	9437
2005	23800	20470	21307
2006	32752	29484	43035
2007	43325	40600	84033
2008	54050	55459	119242
2009-ian.	54625	56023	119299

⁶ Monthly bulletin issued by BNR No. 1/2007 and No. 1/2008

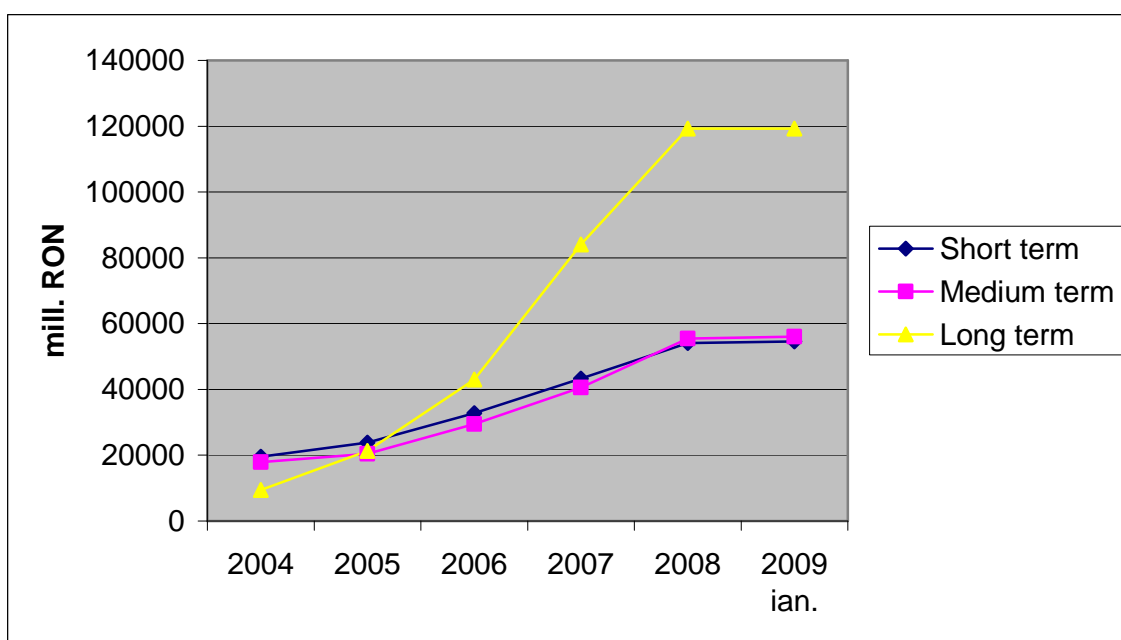


Figure 6. Evolution of loans provided to beneficiaries according to the loan duration

According to the analysed data, at the beginning of the analysed period, the three types of loans have been used in the same amount. We may assert that before 2005 the short-term bank loan has been the most important external financing source. Starting with 2005, the percentage of medium and long term loans are in a visible ascending trend. Therefore, medium and long term bank loans have become a more frequently used financing source for companies, fact that better corresponds to the financing objective of profitable investment projects.

We cannot finalise this report without emphasising the **arrears** issue, a sensitive problem of Romanian economy, though the descending tendency indicated during the last years stands as proof that the Romanian economy is restructuring and enterprises become more and more adapted to the market.

The swift transition to a new economic mechanism at the beginning of the 90s occurred as Romanian enterprises were completely unprepared, whilst the continuance of most companies was conditioned by non-payment of debts and accumulation of arrears. The evolution of arrears has also had subjective causes originating either in the quality of management, or due to the decision-makers' oscillations in applying an appropriate economic policy.

Even if these amounts thus accumulated have had a descending tendency, from 33.4% of the GNP in 2003, to 25.8% in 2004, 18.8% in 2005, 15.5% in 2006, slightly ascending in 2007 to 16.6% of the GNP, these still indicate high values. The frequent use of debt rescheduling and debt write-off have lead to a stock reduction, though with little effect on the improvement of financial discipline. The current efforts to speed-up the restructuring of enterprises that fail to pay, introducing a more strict obligation of payment of fiscal debts, as well as the decision of suppliers cu cut-off the supply to the enterprises that fail to pay have had results in the past period.

The structure of arrears on private sector level, based on the available data provided by balance sheets centralised by the Ministry of Economy and analysed by the National Statistics Commission, indicate that the arrears for suppliers are still maintained at a high level, followed by other back payments (Table 6 and Figure 7):

Table 6. The structure of arrears on private sector level (%)⁷

	2005	2006	2007
Total back payments	100	100	100
<i>of which:</i>			
Debts towards suppliers	56.8	62	61.4
Back payments owed	11.0	8.7	8.4

⁷ Source: National Statistics Commission, revisions of the National Statistics Commission of data from the balance sheets centralised by MEF

to the state			
Back payments owed to the bank sector (loans, interests)	3.3	1.8	2.4
Other back payments	28.9	27.5	27.8

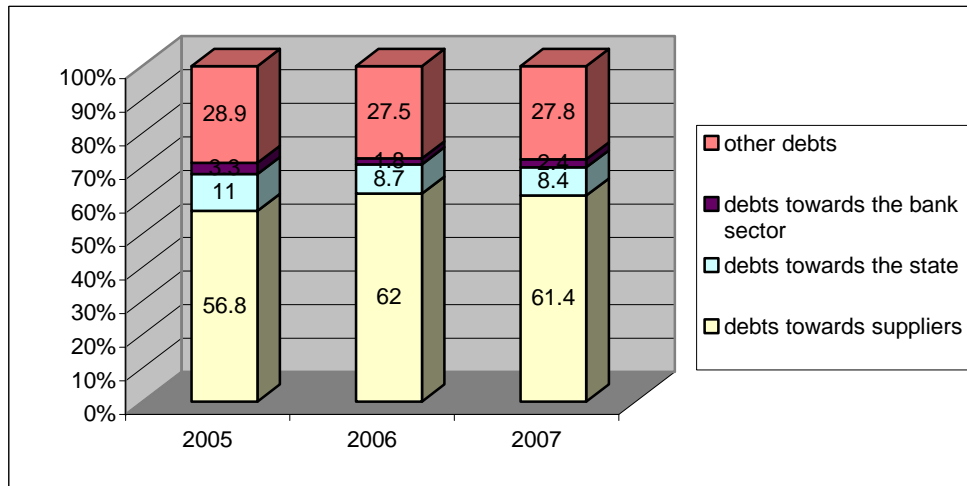


Figure 7. The structure of arrears on private sector level

The percentage of debts owed to the state and banks has had a slight decrease during the analysed period, to the disadvantage of arrears between companies. However, the debts owed to suppliers (commercial loans) represents more than half of the total of arrears. Nevertheless, the ascending tendency of arrears during 2007 is distressing, if we consider that a significant part of the companies function by accumulating debts owed either to the budget, or to suppliers.

If these data are interrelated with the structure of non-governmental loans granted on short, medium and long term, the descending tendency of arrears towards banks is accompanied by the ascending evolution of loans granted to economic agents operating with private capital.

Consequently, the reduction of the inflation rate, supplemented by the decrease of the average interest rate of the banks during the last years have risen the debt levels of Romanian companies. A negative interrelation with the inflation rate may be observed, thus the rise of the inflation rate would cause the decrease of the financing percentage through bank loans with interest (in Romania, during 1991 – 1994 and 1997, when the inflation rate has significantly surpassed the active and passive bank interests). As a negative aspect, arrears represent an important financing source mounting to 35%⁸ of the financing sources of Romanian companies, of which more than half are caused by delay of payment of fiscal debts and debts affiliated to salaries. The diminished rhythm of implementation of legislative and administrative measures to reduce arrears will not prevent arrears from representing a risk for the Romanian economy by maintaining a constant pressure on the aggregate request, inflation and checking account.

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