DECISIONS REGARDING THE FINANCIAL STRUCTURE OF THE COMPANY

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Abstract: The paper presents the relevant aspect regarding the analysis of entity's decisions in the conditions of equilibrium. The authors show the importance of using the indicators in the context of elaborating financial decisions.

Key words: financial policy, leverage effect, financial profitability

1. Introduction

Creating the financial policy, organizing and leading the activity in this field, implies the elaboration of the leadership strategy and a direct practical activity.[29]

Elaborating the general strategy and on areas of financial policy is concludes by adopting certain decisions with normative character, highly strategic, while the leading of the financial activity itself is made through strategic, tactic and operational decisions.[30]

Framing the financial decision in the broader process of financial policy, Professor Constantin Tulai believes that, in the field of finances, *decision* represents an option with executive character make to ensure the transformation of the strategic solution chosen in direct action. Its object is the formation of financial funds, they repartition according to each destination, their rational use and, in the case of economic agents, also the distribution of profit.[31]

2. Method and Results

In our opinion, in the decisional process regarding the financial structure of the company, an important role is held by the leverage effect through which we understand the positive or negative financial result obtained by the company, as a result of using credits as capital. This effect is obtained by comparing the economic profitability of the company (R_e) with the cost of borrowed capital (d).

If $R_e > d \rightarrow$ positive or favorable leverage effect;

If $R_e < d \rightarrow$ negative or unfavorable leverage effect.

$$Leverage\ effect = \frac{Debts \times (Re - d)}{Shareholders'\ equity}$$

So, the leverage effect finds itself in a direct relation both with the financial structure and the difference between profitability ratio (R_e) and interest ratio (d), on the one hand and with the borrowed capital with on the other hand.

Indicator	2 002	2 003	2 004	2 005

[29] *C. Tulai, Public Finance, House of Science Pub., Cluj-Napoca, 2003, p.92*
[30] *Idem*
[31] *Idem*

Profit/Loss	7 229 040	19 759 272	11 912 370	- 4 371 140
Total Assets	183 763 008	213 169 364	289 944 108	305 777 818
Economic Pprofitability (Re)	3,9	9,3	4,1	-1,4

Indicator	2 002	2 003	2 004	2 005
Profit/Loss (B)	7 229 040	19 759 272	11 912 370	- 4 371 140
Shareholders' Equity (Cp)	86 545 935	123 204 887	150 607 746	146 207 167
Financial Pprofitability (Rf)	8,4	16,0	7,9	-3,0

Total Assets (A)	183 763 008	213 169 364	289 944 108	305 777 818
Profit/Loss (B)	7 229 040	19 759 272	11 912 370	- 4 371 140
Shareholders' Equity (Cp)	86 545 935	123 204 887	150 607 746	146 207 167
Total Debts (D)	97 217 073	89 964 477	139 336 362	159 570 651
Interest Expenses	5 300 863	5 982 723	5 111 894	5 451 866
Interest Ratio (d)	5,5	6,7	3,7	3,4

Indicator	2 002	2 003	2 004	2 005
Total Debts (D)	97 217 073	89 964 477	139 336 362	159 570 651
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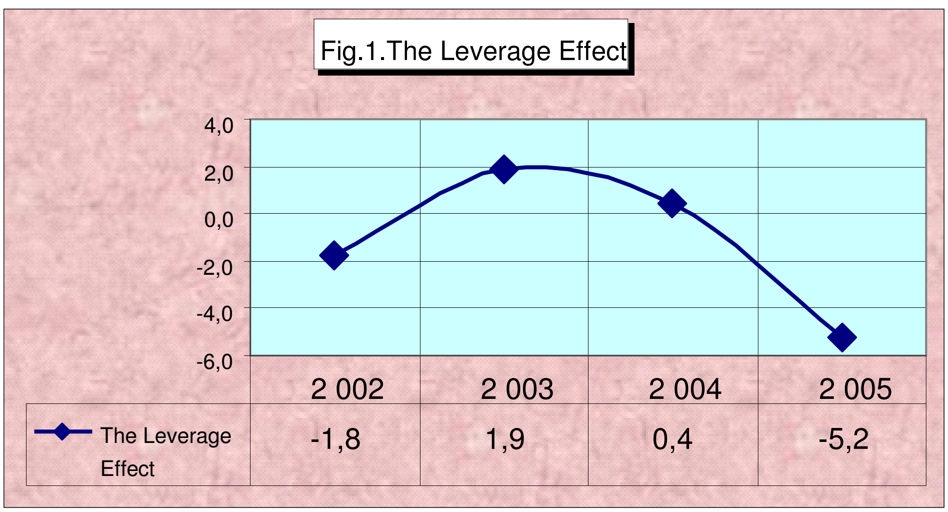
Shareholders' Equity (Cp)	86 545 935	123 204 887	150 607 746	146 207 167
Leverage Efect	-1,8	1,9	0,4	-5,2

Table 1 - The Evolution of the Leverage Effect with SC MARA SA



Both from the above table and from above figure we may notice the effect produced by the leverage on SC MARA SA. In the financial periods 2002 and 2005, the leverage effect transformed in boomerang effect negatively influencing the financial standing of the company. During 2003-2004, leverage was benefic, contributing to the improvement of the financial situation of the company, as well as of its performance.

Adopting a decision regarding the financial structure of the company refers to two coordinates:

- On the one hand, determining the report between permanent capital and short term capital and

- Determining the proportion of each source of permanent capital (shareholders' equity and long term credits) in the total of the balance sheet liabilities (capital structure), so that it would enable the maximization of the company's value.

So, the capital structure signifies the composing elements of permanent funds available to a company. The importance of the capital structure results from the role *leverage* has on the financial profitability (Rf) that is *the profitability of shareholders' equity*, as well as on *the financial risk of the company*, as results from the model below:

$$B = Re *A - d *D = Re(C_p + D) - d*D$$

$$Rf = Re + (Re – d) D/ C_p$$

$$\text{But } r_L = D/C_p$$

Then:

$$Rf = Re + (Re – d) r_L$$

The leverage effect can be extracted from the above relation as follows:

$$E_L = (Re – d) r_L$$

where:

Re = Economic Pprofitability (Benefits/Total assets);

Rf = Financial Pprofitability (Benefits/Shareholders' equity);

A = Total Assets (from the Balance Sheet);

B = Profit generated by the company;

C_p = Shareholders' Equity;

D = Total Debts of the company;

d = Interest Ratio at a monetary unit (d/100);

r_L = Financial Leverage Ratio;

E_L = Financial Leverage Effect

Indicator	2 002	2 003	2 004	2 005
Economic Pprofitability (Re)	3,9	9,3	4,1	-1,4
Total Assets (A)	183 763 008	213 169 364	289 944 108	305 777 818
Interest Ratio (d)	5,5	6,7	3,7	3,4
Total Debts (D)	97 217 073	89 964 477	139 336 362	159 570 651
B = Re *A - d *D	181 981 830	1 379 713 089	673 226 303	- 970 629 159

Indicator	2 002	2 003	2 004	2 005
Economic Pprofitability (Re)	3,9	9,3	4,1	-1,4
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Shareholders' Equity (Cp)	86 545 935	123 204 887	150 607 746	146 207 167
The Financial Profitability $Rf = Re + (Re - d) D/ C_p$	2,10	11,20	4,47	-6,64

Indicator	2 002	2 003	2 004	2 005
Total debts (D)	97 217 073	89 964 477	139 336 362	159 570 651
Shareholders' equity (Cp)	86 545 935	123 204 887	150 607 746	146 207 167
Financial Leverage Ratio ($r_L = D/C_p$)	1,12	0,73	0,93	1,09

The Financial Profitability $Rf = Re + (Re - d) r_L$	2,10	11,20	4,47	-6,64

Indicator	2 002	2 003	2 004	2 005
Economic Pprofitability (Re)	3,9	9,3	4,1	-1,4
Interest Ratio (d)	5,5	6,7	3,7	3,4
Financial Leverage Ratio (r_L)	1,12	0,73	0,93	1,09
Leverage effect (EL = (Re – d) rL)	-1,79	1,90	0,37	-5,23

Table 2 -The Evolution of Financial Pprofitability with SC MARA SA

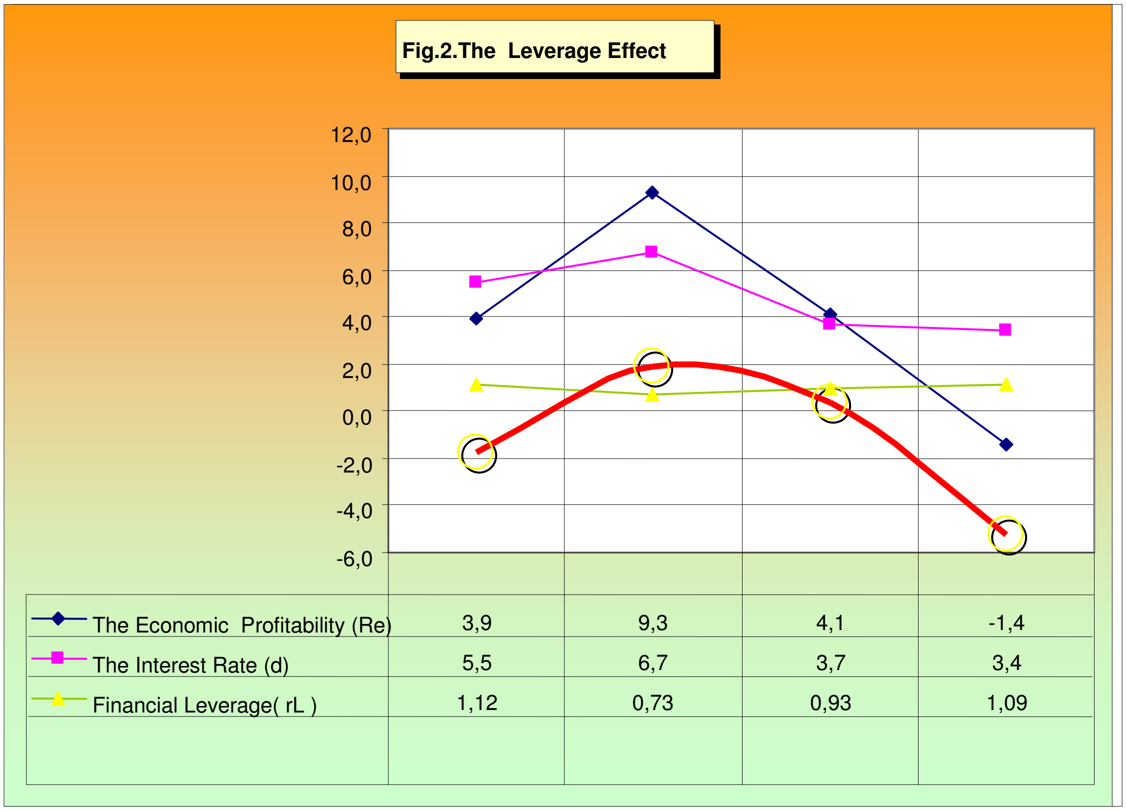

Fig.2.The Leverage Effect

From the graphic representation above we may notice that due to a higher interest ratio in 2002 and 2005, the leverage effect with SC MARA SA recorded negative values, an aspect that we believe to have created a financial instability from the point of view of the investors.

3. Conclusions

The decision regarding the financial structure depends on each company, on its objectives of economic growth, on the foreseen profitability level and on the risk that the company agrees to assume, but also on third parties, that is shareholders, banks and other creditors, on the state as well as on the economic circumstances (position of the financial market, oscillations of the interest ratio, monetary devaluing etc).

At same time, we consider that a negative leverage effect will create financial instability, a lack of financial autonomy and a non – financial equilibrium on the short run.

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