FACTORS INFLUENCING DECISIONS REGARDING THE FINANCIAL STRUCTURE OF THE ENTERPRISE

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In the paper there are presented the importance of the financial structure of the enterprise, the micro and macroeconomic factors that influence decisions on the financing, their characteristics, how they interact between them. All this must be achieved to attain the optimal state of the enterprise. *Keywords: financial structure, capital, microeconomic and macroeconomic factors*

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Introduction

Financial structure of the enterprise reflects the composition of capital and is defined in two ways, either by taking into account the duration or the feature of the capital, either having in view the origin of the capital.[46] The financial structure of the enterprise involves the achievement of the equilibrium between the level of the risk and the rate of profitability.

In order to determine the choice of financing the enterprise should be considered the factors that influence decisions on financial structure. These factors relate to: the structure of assets, the internal conditions of the enterprise, market conditions, profitability, profit margin, growth rate, operational leverage, the instability of sales, taxation, quality of management control of the company, creditors, financial flexibility.

Should be noted that in addition to the remembered microeconomic factors, we must take into account the existence of the macroeconomic factors, of which we mention: inflation, cyclical factors, international and cultural factors.

The paper is structured as follows: a first part dedicated to the microeconomic factors that influence the decisions regarding the financial structure of the enterprise and the second part with the macroeconomic factors that have an influence on it. Last section is dedicated to the conclusions.

The microeconomic factors that influence the decisions regarding the financial structure of the enterprise

Structure of assets refers to assets share in all tangible assets of the enterprises, and those assets that can be used as collateral in order to grant the necessary credits. This means that the enterprise of property and utilities can use more borrowed capital, and those of high technology which have an accelerated rate of growth use less borrowed capital.

Also, assets with high liquidity and a multitude of uses are valid guarantees, while the assets that have special characteristics have low degree of liquidity and are not adequate safeguards.

Internal conditions of the enterprise affect the achievement of the financial structure. Thus, when the market price of shares is low, it will not issue shares to achieve the financing, even if large earnings are expected in the near future, as these earnings are not anticipated by investors, and therefore do not influence the price of market shares to increase it. In this case, it is desirable to achieve the financing of borrowed capital until it materializes the earnings and are reflected in price of the share. Only after that, may be issued and sold shares and capital can be repaid until the borrower considered optimal.

Market conditions, both the market shares and the bond markets and banking markets is amended in the short term and long term and thus influencing the capital structure. If the banking operators

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46 Cristea, Horia; Talpoş, Ioan; Cosma, Dorin, Gestiunea financiară a întreprinderilor, Editura Mirton, Timişoara, 1998, p. 188

during the crisis of money market impose certain restrictions on granting credit to long-term businesses that can not subscribe to restrictions (the example is in an inferior place in the standings of operating banks) will not get credit on long run as achievement of optimal capital structure, being financed on short-term loans or the capital market.[47] When the economic - financial situation of the market improves, those may grant loans in the long run. In crisis situations, the enterprise that occupies a lower place on the bonds market, to achieve the necessary funding must use the shares or bonds on short run.

In it turns, profitability influences decisions regarding the financial structure. It was observed that the enterprise which have a large rate of return on investments, recourse less to the borrowed capital. Explanation would be that enterprises which have high profitability do not need to use too much borrowed capital to finance the loan, being financed from their profits.

Another factor influencing decisions on financial structure is the margin of profit. Its stability is very important, being influenced by the easiness with which businesses can enter the economic branch and the competition capacity to expand production capacities. It is attractive in terms of a profit margin an economic branch in growth.

The entry into this economic branch is relatively easy (does not require large capital investment) and the number of new enterprises grows quite rapidly making profit margin to decrease significantly. If the access into the branch is more difficult, profit margins are not subject to erosion from the competition.

Growth rate is another factor to influence the financial structure. Such enterprise which has a faster rate of growth turns more to the financing of foreign capital, creating a tendency to use debt instruments to a greater extent than enterprises that have a slower growth rate. In addition, the costs necessary to issue and sell shares are higher than those for the issue and sale of bonds.[48]

The effect of operational leverage on the decisions of financial structure is that the enterprise which operational leverage is less is able to use financial leverage to a greater extent. The degree of operational leverage is represented by the way how the changes on sales affect the number of income, and the degree of financial leverage is represented by the way in which changes in operating income affect the operating profit per share.

Stability of sales is that if the sales are stable, the borrowed capital can be used in a greater measure and higher fixed costs may be incurred. Where we have unstable sales, plus a degree of indebtedness, we may think of the probability of bankruptcy with high bankruptcy costs, which leads to lower market value of that enterprise. When we have stable sales, there may be large bankruptcy costs, but the probability to lead to bankrupt is small. This makes enterprise with stable sales to use high debt. Future growth rate of sales is the result of the fact that earnings per share may be increased by the effect of financial leverage.

Taxation influences financial structure, because the higher the rate of enterprise tax is, the more advantageous is for it to use borrowed capital. It is demandable the fact that interest is a deductible tax expense and so there are ensured savings at taxes.[49] Those tax savings are not due to borrowed capital, but to some deductible expenses in calculating the tax. Among those include: accelerated depreciation, digressive depreciation, provisions expressly referred to as deductible, LIFO method of inventory evaluation, providing the meal ticket, benefits offered to the employees. The enterprises intensely capitalized and with a high growth rate can obtain savings on taxes: the interest fiscally deducted is of minor importance, and the enterprises establish a low rate of debt.

Quality management refers to the fact that owner managers of a small enterprise are more cautious than in the large one. Large enterprises with multiple shareholders can decide for selling shares because this affects in a negligible way the control over it. Instead small enterprises, rather

47 Dănescu Tatiana, Gestionarea financiară a afacerilor, Editura Dacia, Cluj-Napoca, 2003, p.65

48 Harpen, P., Weston,J.F., Brigham, E.F., Finanţe manageriale, Editura Economică, Bucureşti, 1998, p.656

49 Harpen, P., Weston,J.F., Brigham, E.F., Finanţe manageriale, Editura Economică, Bucureşti, 1998, p.657

said their owners, avoid the issue of shares to ensure continuity of their control. If the owners have confidence that follows a period of significant earnings, results from some degree of indebtedness, will attract high proportions of debt. When there is only one owner manager, of precaution he may limit the loans and could cause the lost of a share of the fortune.

Control is an important factor in establishing the financial structure. When owner managers whom have control over the enterprise can not or have not the interest to buy new shares, will not resort to financing through issuing shares or selling it, but to finance with borrowed capital. If managers do not have the control of the enterprise and financing with borrowed capital will aggravate the already existing problems and bringing the enterprise into the impossibility to payment, then will turn to the issue and sale of new shares. This does not mean that ownership leads to setting the type of financing that the enterprise will use because the type of capital necessary for keeping control is different from case to case.

Usually, the enterprise managers discuss with creditors about the desired financial structure and they could take account of advice offered by them. Creditors may not accept increases in debt wished by the enterprise or they can accept them, but at a higher price. It is known that increasing the debt leads to the growth of the interest rate of the borrowed capital in the idea of compensation the additional the credit for the supplementary risk beard. However interest rates can increase up to a certain limit, crossing it meaning the bankruptcy of the enterprise. This is aimed to be avoided both by the enterprise and the creditors in the same way and because of this the creditors limited the level of the credit granted.

Financial flexibility reflects the capacity to raise capital in unfavourable circumstances. To ensure the stability of the enterprise is necessary to have a constant offer of capital, regardless of the economic and financial overview. When circumstances are favourable, the financing can be done through the issuing and selling of shares or bonds, but when they are unfavourable, the suppliers of capital prefer bonds. The solution would be to maintainer of an adequate reserve for the borrowing capacity. When they give up on a promising business, but because there are not available funds, is affected on long run the profitability of the enterprise and following that, is affected the market price of the shares. The settlement of this stock for the capacity of borrowing is a problem of the financial manager, but depends of the factors remembered earlier.

In order to determine how the companies choose their financing, must be taken into account the effects caused by factors that affect the financial structure decisions. These are: risk balance - profitability, economic risk (business), financial risk, inflation, cyclical factors, international and cultural factors and the financing effect through the debt or equity position on the control manager.

In terms of financial, profitability is a result of favourable economic activities resulted in increased revenue from financial expenditure incurred and as a result of which has created a surplus value called profits.[50]

Risk is a measure of differences between different outcomes, more or less favourable or unfavourable, to a future action.[51] Between profitability and risk is a direct proportionality as profitability increases, the risk is increased, binomial risk - return underlying arbitration between holding various financial assets and even individuals.[52] Any rational investor aims to maximize earnings and minimize future risk, combining the two elements - and earnings yield - the investor

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50 Ceauşu Iulian - Dicţionar enciclopedic managerial, vol.1, Editura Academică de management, Bucureşti, 2000, p. 671

51 Ceauşu Iulian - Dicţionar enciclopedic managerial, vol.1, Editura Academică de management, Bucureşti, 2000, p. 691

52 Moldovan Nicoleta-Claudia, Costul şi structura capitalului societăţii comerciale- Teorie şi practică, Editura Universităţii de Vest, Timişoara, 2004, p. 215

must decide for one of the following alternatives: high gain / high risk, high gain / moderate risk, low profit / risk low gain and less / lack of risk.[53]
When the economic rate of return is higher than the debt rate, is preferable to resort to loans, having a positive effect on leverage. When it is lower interest rates, the debt must be financed with equity, the leverage effect is negative and decreasing the rate of financial return.
The risk of economic / business is defined as: inherent uncertainty in estimates of future profits or gross financial result, before deducting interest and taxes[54], or degree of uncertainty inherent in forecasting future earnings generated by assets or equity, if the firm does not use borrowed capital financing.[55]
Business risk is different from an economic to another and from one company to another and over time, due to changing competitive structure, technology, economy in general. It is believed that small and with only one type of product enterprises has a relatively high degree of business risk. Industry and food trade or retail industries are having a low risk business, while cyclical industries operations have a high risk business. If two enterprises have the same level of operating profit, which the business risk is highest recorded fluctuations of profit exploitation higher than what the other business risk are lower.
Business risk is determined by the nature of operations performed by the enterprise, the most important factors being:
-variability of demand and the demand for products the enterprise to be stable, the business risk will be lower, as the other variables are constant;
-variability of the price of products sold and services performed, which means that the enterprise that markets its products in markets with high volatility are exposed to a greater business risk than those whose prices are relatively stable;
-variability of prices of production factors manifested in that when prices of production factors are in continuous changing, the enterprise is exposed to a high risk business;
-ability to adjust prices of finished products and services to changes in prices of factors of production means that if this capacity is higher, the degree of business risk is lower. It is clear that some enterprises have no difficulty in terms of higher prices of finished goods and services when the prices of factors of production increase. The importance of this factor is even greater during inflation;
-the level of the operating leverage explained by the fact that when an enterprise in which a significant part of total costs are fixed and can not be reduced when demand decreases, there is an increase in business risk.
Each factor of the shown ones is determined by the characteristics of the branch in which the enterprise operates, while each factor can be controlled in some measure by the management of the enterprise. Of course, this involves the more expenditure on advertising or price discounts in order to convince customers to buy fixed quantities in the future at fixed prices.
The business risk is a direct function of allocating capital. Once made these decisions, they affect the company as business nature and composition of its assets.[56]
Financial risk is the risk to be further supported by the holders of ordinary shares as a result of the use of financial lever[57], is the result of decisions of long-term financing, being represented by a variable increase revenue potential holders of common shares and increased the likelihood of

53 Tudose Mihaela-Brânduşa, Gestiunea capitalurilor întreprinderii – Optimizarea structurii financiare, Editura Economică, Bucureşti, 2006, p. 211
54 Cocriş Vasile, Economia afacerilor, Editura Graphix, Iaşi, vol. 3, p.41
55 Hoanţă Nicolae, Finanţele firmei, Editura Continent, Sibiu, 1996, p. 233
56 Hoanţă Nicolae, Finanţele firmei, Editura Continent, Sibiu, 1996, p.234
57 Harpen, P., Weston,J.F., Brigham, E.F., Finanţe manageriale, Editura Economică, Bucureşti, 1998, p.634

financial danger to the owners if it use financial leverage.[58] Financial leverage refers to the use of securities with a fixed income which have a payment priority over equity.[59]
Financial risk is characterizing the variability of net profit under the capital structure. Money borrowed by their size and pay of systematic financial expenses, involve a net profit variability, so an increase in financial risk.[60] To analyze variability of net profit are two methods: the method based on the threshold of profitability and the effect of financial leverage.

The macroeconomic factors that influence the decisions regarding the financial structure of the enterprise

Financial structure is influenced by inflation, cyclical factors, and international culture. Inflation is a macroeconomic indicator of great importance, as influencing any economic variable. Opinions are divided as regards the relationship between inflation and capital structure. Some authors maintain that the relationship between the two is negative, because it turns investors borrowed capital in equity because the return on real capital becomes relatively more important than profitability indebtedness. However, most of them are of the opinion that between inflation and capital structure is a positive relationship. For example F. Modigliani argues that inflation should increase the benefit by increasing the indebtedness on which a record financial leverage[61].
B. Zwick is of the opinion that the existence of inflation, the preferred use of debt financing when the actual cost of debt is decreasing. When inflation and interest rate recorded an increase equal, will decrease the cost of indebtedness by deducting taxes. In contrast to this view are the JR Franks and J.E. Broyles, who believes that businesses do not tend to borrow in terms of high inflation, as they pay more expensive lend money when the inflation rate will increase over the foreseeable businesses that lease record earnings, while inflation will fall, they will lose[62].
Also, periods of economic prosperity and recession are affecting the capital structure. Enterprises can, in periods of economic recovery, to finance from the accumulated profits and stocks, not of indebtedness, because in this case, the long run lending decreases.
Moreover, the capital structure of an enterprise is influenced by market conditions on the issuance of shares. When the current price of shares is low, and there is forecast a supplementary earning, is preferred issuance and sale of bonds and not shares. Issuance of shares is preferred after the periods of strong performance of market shares, and issuing bonds when interest rates are low or are expected to grow.
International factors that have an influence on the financial structure refers to: protectionist strategies, repatriation of capital, government incentives for the collection of funds from abroad.
Among the cultural factors that have an important determinant of financial structure include: stage of development of capital markets, the social distribution of income, accounting system, tax system.

Conclusions

In addition to its objectives of growth, profitability, risks, the enterprise, in the moment of determining the financial structure, should take account of shareholders, banks, financial state, market situation, macroeconomic stability of the country, local traditions relating to business, the development of credit, interest rate, inflation and economic - financial situation.

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58 Hoanţă Nicolae, Finanţele firmei, Editura Continent, Sibiu, 1996, p.234
59 Harpen, P., Weston,J.F., Brigham, E.F., Finanţe manageriale, Editura Economică, Bucureşti, 1998, p.634
60 Stancu Ion, Finanţe, Editura Economică, Bucureşti, 2002, p.870
61 Modigliani F., Debt, Dividend Policy Taxes, Inflation and Market Valuation, Journal of Finance, vol. 37, 1982, pp.255-273
62 Moldovan Nicoleta-Claudia, Costul şi structura capitalului societăţii comerciale- Teorie şi practică, Editura Universităţii de Vest, Timişoara, 2004, p. 228-229

Another factor to note is the creditor, better said the risks to which is exposed (risk of loosing the capital when the debtor is unable to repay the amount, interest rate risk, the inability of the payment of interest by the debtor term, risk restraint, which exists when the debt payment period, by blocking borrowed capital). In order to protect from these risks, the creditor requires insurers and guarantee participation by the debtor to finance capital.

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