

FINANCIAL STRUCTURE OF THE FIRM

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The **firm financial structure** problem constitutes one of the important problems of the financial management. The choice of the financial structure of a firm is an old problem, and, in the same time difficult. Its “delicate feature” comes from the fact that, it still hasn't been given a unanimous accepted answer, for the question *is a firm to much or sufficient indebts*. About this question, there is a series of theories and opinion, some contradictory, which complicates more the problem.

Within the financial politic of any modern firm, the necessity to choose an oportune financial structure represents a priority. This politic must be within the norms of the general strategy of the firm, depending on the conjuncture realities and the activities domain of the firm, to accomplish the desired objectives.

In conformity with the base objective of the financial function of the firm, the manager preoccupation is the continuous increase of the firm value, so to be realized a maximization of it reported to the structure of the actives that compose it. If the firm value maximization objective is followed in every investment project which is intentioned to be accomplished, by obtaining a even bigger discounted value, the firm considered as a sum of investments projects will grow in value. But the net present value is bigger either because they obtained some bigger cash flows, or because they registered a balanced medium cost of the invested capital as small as possible, balanced medium cost which represents the discounted rate of the investment's cash flows.

So, the realization of an optimal financial structure of the invested capital will allow the minimization of the balanced medium cost and, of course the firm's value maximization.

Therefore exists, an interdependence between the cost of the capital and the financial structure and that is why the structure optimization problem is a problem of strategic financial management which makes the difference from the efficiency point of view, between competitors with similar financial efforts.

The financial structure means the dividing of the firm financial resources between own capitals and borrowed capitals (debts). These often are mistaken with the debts/own capitals report called financial lever.

The financial structure optimization requires the establishment of that combination between own capitals and the borrowed ones defined in terms of profitability and risk to maximize the firm's actions value. So, the choice of a optimum financial structure is essential for any firm, because it will directly determine, its profitability and risk.

We appreciate that the notion of “ideal financial structure” or “optimal financial structure” of a firm is hard to be established. Otherwise, in time, the “equilibrated” financial structure notion had suffered multiple modifications:

- in the '50, it was considered that a firm has a good financial structure when it had a small indebt; so, the accent was put on the financial autonomy of the firm, in a context characterized by economical stability;

- in the '60 and the '70, a good financial structure should had what is considered to be a “normal” indebt, meaning lower than its own capitals; so the accent was on the debt's financial lever, within a very big economical increase and a low debt's real rate;

- starting with the '80, a good structure should have a balance significance of the firm financial structure characterized through a progressive movement of the indebt, an improvement of the auto-financing and of the financial profitability.

The decrease of the indebt interest after the '80 is explained through the risks involved by this financial method such for the indebted as much as for the loaner. From the point of view of the firm that takes the loan the indebt involves the risk not to be able to support the payment obligation for the creditors, a too big volume of not honored eligible debts can bring it in state of insolvency.

Regarding the financial structure, the following aspects are to be emphasized:

- the rentable and viable firm, due to their products, is possible never to know any kind of important bursary difficulty due to a big indebt;

- the firms that are not rentable and viable on a long term period because of the quality of their product, will have important bursary problems indifferent of their financial structure.

The adoption of a certain financial structure is the result of a decisional process of the firm which can not be accomplished without thinking of constrains resulted from the capital market functioning, knowing that any kind of capital costs. So, the capital structure is a variable which doesn't depends only by the firm, by its economical increase objectives, by the profitability or risks that are involved. This is influenced and often determined also by shareholders, banks or others loaners, by the state, as well as by the economic-financial conjuncture.

The financial structure rates are orientation parameters to lead the firm

regarding the influence of the financial sources cost upon the efficiency level, but also the indices for the potential creditors regarding the risk of recover the borrowed capitals.

In this way, there are calculated and interpreted many financial structure rates, from which we nominate:

- *the patrimonial solvability (P.s.)*, represents the degree in which the firm can handle the payment obligations and it is calculated as the report between the own capital and the total passive from the firm's balance sheet:

$$P.s. = \frac{\text{Equity}}{\text{Total passive}} \cdot 100 \quad (1)$$

The patrimonial solvability is considered to be good, when the obtained result surpass 30%, indicating its own sources in the total passives of the firm.

- *the financial autonomy rate (F.a.r.)* is given by its equity and the permanent capital report:

$$F.a.r. = \frac{\text{Equity}}{\text{Permanent capital}} \quad (2)$$

This report mirrors the degree in which the firm utilizes its own capitals and expresses its degree of independence from the permanent creditors. Because of the reasons imposed by the bank's norms, in the credit relations with the firm, this report must be bigger or equal with 0, 5.

The smaller this report is, the more the firm depends by its creditors, and the bigger this report is, the higher the independence degree is.

- *the financial debts rate (F.d.r.) (the long and medium term debts)* is a complementary rate with the financial autonomy rate and it is given by the report between the long and medium term debts and the permanent capital:

$$F.d.r. = \frac{\text{Long and medium term debts}}{\text{Permanent capital}} \quad (3)$$

Further on, the firm can benefit of a long and medium term indebt as long as this rate is smaller than 0, 5.

- *the debts rate (D.r.)* is a rate that depends on the assembly of the debts

and it is given by the total debts and total assets report, being considered to be a stability rate.

$$D.r.=\frac{\text{Total debts}}{\text{Total assets}} \quad (4)$$

- *the equity rate against the fixed assets* express the financial capital assets condition.

$$Eq/F.a.=\frac{\text{Equity}}{\text{Fixed assets}} \quad (5)$$

An over unitary values signifies the fact that the capital assets assembly is financed from its equity.

- *the general (global) liquidity* reflects the possibility of the current patrimonial components to transform in a short term in liquidities to satisfy exigible payment obligations and is calculated after the following relation:

$$G.l.=\frac{\text{Current assets}}{\text{Current debts}} \quad (6)$$

The general liquidity is appreciated to be favorable when it has an over unitary measure (between 2 and 2.5). When the report is bigger then one the firm is better put at shelter by a bursary insufficiency which could be provoked by the debts repayment at the ledger request.

- *the immediate liquidity* express the firm capacity to honor the short term debts from debt and liquid assets:

$$I.l.=\frac{\text{Current assets - Stocks}}{\text{Current debts}} \quad (7)$$

In economic theory is appreciated that a rate between 0.8 and 1 represents the optimal situations.

- *the general solvability rate* is given by the total assets and current debts report:

$$G.s.r.=\frac{\text{Total assets}}{\text{Current debts}} \quad (8)$$

- *the financial security* – reflects the degree in which its own capitals assures the activity finance, comparing its own resources with the medium and long term debts:

$$F.s.=\frac{\text{Equity}}{\text{Medium and long term debts}} \quad (9)$$

When its capital is smaller then the term debts, meaning that the F.s. is under unitary, the theoretical loan capacity of the firm is saturated. That's why the bank's norms recommends an over unitary report.

- *the indebt degree* shows the limit to which the firm is financed by other sources then its own capitals. So this indicates the measure in which its short, medium and long term engagements are guaranteed by the firm's own capitals.

We can mention:

- *the general indebt degree:*

$$G.i.d.=\frac{\text{Total debts}}{\text{Equity}} \cdot 100 \quad (10)$$

- *the financial indebt degree:*

$$F.i.d.=\frac{\text{Medium and long term debts}}{\text{Equity}} \cdot 100 \quad (11)$$

To appreciate the obtained result for this indicator is important to know that the bank participate at the financing of an economical agent together with the owners, but can not risk more than those, because the bank's benefit is the interest rate and not the dividend.

The regularly used scale to appreciate the indebt degree is represented in the following table:

	General indebt degree	Financial indebt degree
Good	<60%	<30%
Satisfactory	60-100%	30-70%
unsatisfactory	> 100%	>70%

As the indebt level increases, a decrease of the stocks course on the market takes place. The banks are going to pretend a higher interest rate to assure a bigger risk prime, following to interrupt the accreditation at an indebt level considered to be critical. In the same time, the indebt increase will progressively decrease the firm rated capacity, the shareholders being obliged to give up, in a significant proportion, to their dividends and to capitalize the profit as a premise of the future dividend increase.

Complementary, in the analysis can be also utilized helpful rates which do not strictly refer to the balance sheet passive structure:

- The gross self-financing degree =
$$= \frac{\text{Gross self – financing}}{\text{Investments}} \quad (12)$$

the rate express how much from the investments value is covered from the internal firm resources (net profit and depreciation);

- The net self-financing degree =
$$= \frac{\text{Net self – financing}}{\text{Investments}} \quad (13)$$

the rate express how much from the investments value is financed from the net profit reserved for the development;

- The investment rate =
$$= \frac{\text{Investments}}{\text{Added value}} \quad (14)$$

the rate expresses the firm tendency to invest, appreciating the firm development following the investment politic.

$$\begin{aligned} \text{The own resources retain rate} &= \\ &= \frac{\text{Gross self – financing}}{\text{Added value}} \quad (15) \end{aligned}$$

The rate expresses the firm disposition to economize, respectively to capitalize reported to the wealth created by it (the new created value).

The interpretation of each rate suggests one or other important aspects of the financing and the structure of this financing. But, to increase the exactness degree of the analysis results and, implicit, of the fundament for further decisions, is also necessary to calculate the aggregate indicators to express multi-criterial the influence of the diverse financial sources and, in the same time, to establish, more real, the firm position on the market.

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