STUDY ON THE MICROECONOMIC FINANCING DECISION

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ABSTRACT: *The purpose of the action taken by the authors is to demonstrate that, in order to substantiate the financing decision within an economic entity, the starting point is the principle according to which current assets are financed from short-term sources and fixed assets - from long-term sources. The financing decision must be taken on the basis of the correlation between the costs of capital and the profitability of the financing projects. The objective of this paper is to demonstrate that the objective of an economic entity is to achieve the lowest cost of capital acquisition, under a reasonable and controllable degree of indebtedness, as demonstrated by an empirical study on the example of an economic entity in Hunedoara County. The article concludes with the authors' conclusions on the need to improve the timing of the debt collection gap and the average debt repayment period, with positive influences on net cash; increasing the profitability of the economic entity's activity through measures to optimize expenditures; ensuring financial autonomy for the entity.*

KEY WORDS: *financial analysis, financial autonomy, cost of capital, financial decision, economic entity, cost optimization, profitability.*

JEL CLASSIFICATION: *G29, M41.*

1. INTRODUCTION

The diagnostic activity at the end of the financial year, of the state of financial performance within an economic entity, is performed through the financial analysis. The purpose of the financial analysis is to highlight the ways in which the financial balance is achieved, both long-term and short-term, as well as the steps of money accumulation and profitability of an economic entity.

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The object of the financial analysis is defined by the research topics imposed on an economic entity through various constraints. Mainly, the financial analysis focuses on how the economic entity can overcome the constraints on performance, solvency, autonomy and financial flexibility. For financial analysis, data sources consist of summary accounting documents, such as: balance sheet, income statement and balance sheet annexes.

The common information found in both documents, respectively, both in the balance sheet and in the income statement is the net result (profit or loss), as a reflection of the profitability of the economic entity and the new balance sheet in which it is found. It is known that the objective of any economic activity is to maximize the profit obtained, while maintaining a cost of production as low as possible.

Therefore, financial analysis is the basic component of financial management, and financial management is the art of managing the finances of an economic entity, ie the relationships associated with the formation and use of its capital and income.

Long-term money management is the process of making decisions in the field of fund investments, which means that when the manager of an economic entity has to make certain decisions, such as expanding the business by acquiring new fixed assets, an important part of this decision will be the consideration of the ability to generate economic benefits, as well as a positive cash flow. If assets and liabilities are balanced over time, a balance of cash inflows and outflows and a financial balance of the economic entity are also ensured.

Therefore, financial analysis data characterize the absolute efficiency in the management of an economic entity, and the results of the financial analysis allow us to identify the vulnerable points that need special attention, as their identification allows the best measures to be taken to eliminate them.

2. RESEARCH METHODOLOGY

The authors in the research approach followed some principles and rules specific to the research methodology, including the review of the literature, the collection and processing of conclusive data and information, the synthesis of theoretical and practical aspects.

The methods used were: deductive research, statistical grouping, observation, comparison, case study, economic analysis and interpretation of the results obtained. Theoretical research analyzes and describes the current state of knowledge as a result of theoretical documentation, both nationally and internationally, and empirical research complements the theoretical research by putting into practice the information on the financing decision within an economic entity.

3. FINANCING DECISION AND SHORT-TERM FUNDING SOURCES

The set of activities and operations carried out, starting from the supply of raw materials, consumables, etc. and continuing with the collection of receivables from customers - beneficiaries of goods delivered, services provided or works performed, is the operating cycle of an economic entity, and the financing of the operating cycle is the set of short-term financing, lasting up to one year. In the operating cycle, successive stocks are formed by buying goods from third parties, storing and processing them, and finally delivery to customers.

The management of the operating cycle aims at increasing the profitability of the activity in conditions of diminishing the economic and financial risk. The harmonization of the profitability-risk relationship is achieved within the balance between the need for current assets and the sources mobilized for its completion. Therefore, operating cycle financing provides the sources of financing for short-term allocations called current assets or current assets.

In order to substantiate the financing decision, the principle according to which current assets are financed from short-term sources and fixed assets from long-term sources is respected. Depending on how it is set up, the sources of financing the operating cycle are from own sources, attracted and borrowed.

Financing the financing cycle from own sources ensures financial autonomy, and the risk of unforeseen withdrawal of capital is practically non-existent. The financing of the financing cycle from permanent sources is justified by the renewable nature of current assets, and if there are no structural changes there is a minimum level of current assets to be financed.

Attracted sources, also called operating liabilities, have a level, structure and evolution depending on the characteristics of the operating cycle that determine both the size of the operating liabilities and their maturity. Until the maturity date, the debts of the economic entity to third parties are sources of capital attracted to finance some needs of the operating cycle.

The sources borrowed to finance the operating cycle are short-term loans with a maturity of less than one year, obtained from credit institutions.

4. FINANCING DECISION AND SOURCES OF LONG-TERM FINANCING

In order to carry out its specific activity, each economic entity needs important sources of financing both for the operating cycle and for the development, restructuring and / or modernization activity. Thus, the economic entity, in order to provide long-term financing sources, in addition to equity (share capital, capital-related premiums, reserves, current income, deferred income) is constrained to use borrowed capital which consists of loans from the issue of bonds, medium and long-term loans from credit institutions and leasing, respectively.

The own capitals are formed from external contributions (the contribution of the owners, possibly the contribution of the state, of some specialized bodies or collectivities) and internal (resources that emerge from the self-financing capacity of the economic entity).

Contributions in cash are sources of direct financing, and in-kind contributions are forms of indirect financing. The most efficient way to finance permanent capital needs is through self-financing, but sometimes this is insufficient and it is necessary to resort to external capital contributions that can be their own, through new capital contributions, both in cash and in kind or borrowed.

Total self-financing has two components, namely maintenance self-financing and net self-financing. The maintenance is formed by the establishment of depreciation and provisions, ensuring the maintenance of the level of assets reached at a given time, and net self-financing ensures the capitalization of the company, by allocating a share of profit for development, increasing the financial autonomy of the company.

The basic financial instruments of the capital market are stocks, and by trading them, some investors have the opportunity to make a profit and at the same time, economic entities have the opportunity to finance themselves. Investors can make a profit by buying shares at a certain price and selling at a higher price, and companies can finance themselves by issuing new shares and selling them to interested investors.

The internal contributions to the formation of own capitals are released from the own activity ensuring the self-financing with positive effects on the financial autonomy. In order to carry out specific activities, expenses are incurred and three categories of income are generated, respectively: operating, financial and extraordinary.

With regard to borrowed capital, leasing is a modern and advantageous form of financing for the provision of fixed capital elements necessary for the activity of economic entities.

Leasing is both an alternative form of financing for investment and a form of trade. Depending on the participants in the leasing operations, there are two forms of leasing: direct (operations carried out between the manufacturer and the beneficiary) and indirect (between the supplier and the user there is a specialized company).

Depending on the contractual clauses, there are two types of leasing, operational (the user returns the good or has the option to extend the contract) and financial (the user becomes the owner of the good after paying a residual value).

Bond loans represent the equivalent value of bonds issued by public subscription. After the economic entity has issued bonds, it will regularly pay interest, according to the assumed obligations, and at the maturity of the loan, the nominal value of the purchased bonds will be repaid to the investors.

5. THE DECISION AND THE SOURCES OF FINANCING OF AN ECONOMIC ENTITY FROM ROMANIA

The operational responsibilities of financial management within an economic entity are divided into three phases of a fundamental cycle, namely a first phase of financial diagnosis or financial analysis, which assesses the financial situation and performance of the entity, highlighting the strengths and weaknesses in order to take managerial measures to eliminate deficiencies and capitalize on those advantages, the second phase of establishing and making financial decisions based on the analysis and identification of the best solutions to maximize the value of the economic entity and the third phase and the control of projects whose implementation has been decided and allows the identification of deviations from the actual achievements, compared to the initial projects, as well as the taking of corrective measures.

The empirical study was conducted on the example of an economic entity whose main activity is restaurants and other food service activities. The activity of this entity takes place in Hunedoara County. At the beginning of 2021, the average number of employees was 49, the expenses regarding the salaries amounting to 1,480,599 lei. At the beginning of 2021, the company registered a turnover of 6,012,543 lei and a net profit of 1,945,238 lei.

5.1. The main economic and financial indicators determined on the basis of the simplified balance sheet

The main economic-financial indicators were determined based on the accounting data from the balance sheet, structured according to the financial criteria and recorded in the financial years 2019 and 2020, being presented in table 1.

Table 1. Structuring the balance sheet according to financial criteria

- lei -

No	**Explanations**	**In 2019**	**In 2020**
1	Tangible fixed assets	2,376,135	3,302,730
2	Permanent allocations (fixed assets)	2,376,135	3,302,730
3	Inventories	43,245	167,694
4	claims		655,839
5	Cash	1,792,262	1,658,329
6	Cyclic allocations (current assets 3 + 4 + 5)	1,835,507	2,481,862
7	Equity	2,350,045	1,948,504
8	Medium and long term debt	188,509	1,252,061
9	Permanent sources (7 + 8)	2,538,554	3,200,565
10	Operating debts	1,673,088	1,761,393
11	Short-term loans	-	822,635
12	Cyclic sources (10 + 11)	1,673,088	2,584,028

Thus, the following indicators were determined:

1) Liquidity indicators

$$\text{Current liquidity} = \frac{current\ assets}{current\ debts} = \frac{2.481.862\ lei}{2.584.028\ lei} = 0{,}96 \quad (1)$$

$$\text{Immediate liquidity} = \frac{current\ assets - stocks}{current\ debts} = \frac{2.314.168\ lei}{2.584.028\ lei} = 0{,}90 \quad (2)$$

2) Risk indicators

$$\text{Degree of indebtedness} = \frac{borrowed\ capital}{own\ capital} \text{ x } 100 = \frac{800.000\ lei}{1.984.504\ lei} \text{ x } 100 = 40\% \quad (3)$$

3) Activity indicators

$$\text{Rotation rate of fixed assets} = = \frac{fiscal\ value}{fixed\ assets} = \frac{6.012.543\ lei}{3.302.730\ lei} = 1{,}82 \quad (4)$$

$$\text{Total asset turnover} = \frac{fiscal\ value}{total\ assets} = \frac{6.012.543\ lei}{5.784.592\ lei} = 1{,}04 \quad (5)$$

4) Profitability indicators

$$\text{Return on capital employed} = \frac{profit\ before\ payment\ of\ income\ tax}{committed\ capital} = \quad (6)$$

$$= \frac{1.959.174\ lei}{5.784.592\ lei} = 0{,}34$$

Also, based on the structured data from the balance sheet, the analysis of the structure rates of the economic entity's liabilities was performed, which allows the assessment of the structure and financial policy of the economic entity, by highlighting the composition of liabilities. By financial structure is meant the relationship between short-term and medium-term and long-term financing that influences the financial management of the economic entity, by the costs it determines (cost of capital), its profitability is affected and investment policy is determined.

Therefore, the choice of a certain financial structure is an important aspect of the financial policy, and the decision of the financial structure depends on the objectives of the economic entity, the level of expected profitability, as well as the risks assumed. At the same time, in addition to the internal factors, the decision of the financial structure also depends on certain factors external to the economic entity, such as the economic situation - the situation of the financial market, inflation, interest rate fluctuations.

Thus, the following structure rates of the liability were determined:

1) Financial stability rate (Rsf) which reflects the link between permanent capital which the economic entity has on a stable basis (for a period of at least 1 year) and the total patrimony.

$$Rsf_{2019} = \frac{permanent\ capital}{total\ liabilities} \text{ x } 100 = \frac{2.538.554\ lei}{4.211.642\ lei} = 0{,}60 \quad (7)$$

$$Rsf_{2020} = \frac{permanent\ capital}{total\ liabilities} \text{ x } 100 = \frac{3.200.565\ lei}{5.784.592\ lei} = 0{,}55 \quad (8)$$

The economic entity is in a favorable situation as a result of the values between 50% and 66% highlighting the permanent nature of the financing, which gives a certain security to the entity in carrying out its activities.

2) The overall financial autonomy rate (Rafg) expresses the entity's suitability to meet financial commitments, measured by rates that express the degree of liquidity-solvency and the degree of indebtedness.

$$\text{Rafg}_{2019} = \frac{own\ capital}{total\ liabilities} \text{ x } 100 = \frac{2.350.045\ lei}{4.211.642\ lei} = 0{,}55; \quad (9)$$

$$\text{Rafg}_{2020} = \frac{own\ capital}{total\ liabilities}\ 100 = \frac{1.948.504\ lei}{5.784.592\ lei} = 0{,}33 \quad (10)$$

It is difficult to establish a reference rate, as the share of equity, respect for liabilities in total liabilities differs from one case to another, depending on both the financial policy of each economic entity and the specific conditions of each entity. partly by the efficiency of financial decisions. Thus, in the literature, a rate higher than 0.33 or 33% is recommended as satisfactory for the financial balance.

3) The rate of financial autonomy in the long term allows a more accurate assessment, through
involvement of the permanent capital structure, as follows:

$$\text{Raft}_{2019} = \frac{own\ capital}{permanent\ capital} \text{ x } 100 = \frac{2.350.045\ lei}{2.538.554\ lei} = 0{,}92; \quad (11)$$

$$\text{Raft}_{2020} = \frac{own\ capital}{permanent\ capital} \text{ x } 100 = \frac{1.948.504\ lei}{3.200.565\ lei} = 0{,}61 \quad (12)$$

To ensure financial autonomy, equity is considered to be at least half of the permanent capital, ie (0.5). Below this limit, the economic entity would be in an unfavorable situation with regard to the risk of insolvency and would thus be affected by its financial autonomy, which is not the case for the entity under analysis.

4) The global indebtedness rate (Rîg) measures the share of debts in the patrimony economic entity and expresses the degree of dependence of the entity on financial resources from third parties:

$$\text{Rîg}_{2019} = \frac{total\ debts}{total\ passives} \text{ x } 100 = \frac{1.861.597\ lei}{4.211.642\ lei} = 0{,}44 \quad (13)$$

$$\text{Rîg}_{2020} = \frac{total\ debts}{total\ passives} \text{ x } 100 = \frac{3.836.089\ lei}{5.784.592\ lei} = 0{,}66 \quad (14)$$

The further away the value of this indicator is from 0.5 or 0.66, the higher the financial autonomy of the company, the lower the risk of insolvency, and the economic entity has the capacity to borrow.

5.2. Analysis of the financing decision based on financial balance indicators

Also depending on the structure of the financial balance sheet, the financial balance indicators are determined, respectively the working capital, the necessary working capital and the net treasury.

1) Working capital (FR) = Permanent sources - Permanent allocations = (15)
= (Equity + Debts on TM and TL) - Fixed assets
FR_{2019} = (2,350,045 lei + 188,509 lei) - 2,376,135 lei = 162,419 lei
FR_{2020} = (1,948,504 lei + 1,252,061 lei) - 3,302,730 lei = - 102,165 lei

2) Equity (FRP) = Equity - Fixed Assets (16)
FRP_{2019} = 2,350,044 lei - 2,376,135 lei = 153,909 lei
FRP_{2020} = 1,948,504 lei - 3,302,730 lei = - 1,354,226 lei

4) Working capital requirements (NFR) = (Stocks + Receivables) - Operating liabilities (17)
NFR_{2019} = 43,245 lei - 1,673,088 lei = -1,629,843 lei
NFR_{2020} = 823,533 lei - 1,761,393 lei = - 937,860 lei

5) Net Treasury (TN) = FR – NFR (18)
TN_{2019} = 162,419 lei + 1,629,843 lei = 1,792,262 lei
TN_{2020} = - 102,165 lei + 937,860 lei = 835,695 lei

The analysis of these results reveals the following aspects:

- the working capital in 2019 registered positive values which means a state of financial equilibrium, the permanent allocations in fixed assets being covered in their entirety from permanent sources consisting of equity and medium and long term debts with a maturity of more than 1 year ;
- the process of financing fixed assets generates a working capital surplus that can be used to finance operating needs;
- the working capital recorded positive values, which means that the financing of fixed assets can fully insure their own capital, there is even a surplus that can be used to finance current assets;
- in 2020, the working capital recorded negative values, so that the permanent allocations in fixed assets are partially financed from permanent sources consisting of equity and debts with a maturity of more than 1 year, with the possibility of resorting to short-term financing sources in to the detriment of some needs of the operating cycle;
- the share capital of the analyzed entity is 220 lei, specific to limited liability companies;
- the profit realized in 2019 was distributed in full for the granting of dividends, so that, although the entity made a profit, it does not go through a capitalization process, the profit not being allocated for development; and the one from 2020 was an element of the own capitals to be distributed;

- reserves were set up in the amount of 3,047 lei;
- debts with a maturity of more than 1 year represent debts from leasing operations, in the amount of 188,509 lei in 2019 and 1,252,061 lei respectively in 2020, which consist of a leasing contract regarding some means of transport necessary for the good development of the activity. ;
- The required working capital was negative in both years, which means that cyclical allocations in inventories and receivables are lower than operating liabilities, such as debts to suppliers, debts to the state - taxes and duties, debts to various creditors, debts to employees;
- notes that there is a favorable gap between the average duration of debt collection and the average duration of debt repayment, with positive effects on net cash;
- During the analyzed period, the net treasury registered positive values, which means a state of financial balance that ensures the financial autonomy of the economic entity, being the result of a profitable activity and the synchronization of receipts with payments.

6. CONCLUSIONS

From the analysis made, some conclusions can be drawn regarding the economic entity in question. Thus, it can be said that the financing decisions influence the financial structure of the company as well as the average cost of capital, the objective pursued by the management being to obtain the lowest cost of capital acquisition, under conditions of a reasonable and controllable degree of indebtedness.

Therefore, the financing decision must be taken as a result of the correlation between the costs of capital and the profitability of the projects undertaken. The normal values recorded by the financial stability rate place the economic entity in a favorable situation and highlight the permanent nature of the financing, which confers a certain state of security in carrying out its own activity. Also, the rate of financial autonomy indicates a satisfactory level for maintaining the financial balance, and the overall indebtedness rate indicates an increase of financial autonomy, the risk of insolvency being quite low and the economic entity having the capacity to borrow.

The analysis of the financial equilibrium indicators shows a state of financial equilibrium, the permanent allocations being fully covered by permanent sources consisting of equity and medium and long-term debts, with a maturity of more than 1 year. Also, the process of financing fixed assets generates a surplus at the level of working capital that can be used to finance some needs of the operating cycle.

Particular attention should be paid to permanent allocations as in 2020 they were partially financed from permanent capital and debts with a maturity of more than 1 year, there is a need to resort to short-term financing sources, to the detriment of some needs of the operating cycle, aspect also attributed to the 2020 pandemic year with continuity in the following years.

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