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## FINANCIAL FLOWS, FINANCIAL STABILITY AND MANAGING THE CAPITAL STRUCTURE IN EMERGING COUNTRY

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**Abstract:** New financial flows and the development of fin-tech are making up different rules of managing the structural of company's capital. The globalization brings new views and acting of managers for using financial sources and rise of the company. So, capital structure is linked with financial market development, market conditions, availability of debt, type of industry sector as the control of managers. Capital structure is linked with company's success. Measuring the profitability of the company is not enough due to the fact that there are cases where profitable company does bankrupt. That is the reason in this paper to analyze the financing performance and successful managing of the financial (capital) structure in Macedonia. The companies (the sample in the survey) are divided on companies which have opened bankruptcy proceeding in 2021 and companies which haven't opened bankruptcy proceeding in 2021. The analysis of the survey is done by Chi-square test, T-test and Levene's test for equality of variances.

**Keywords:** Capital Structure, Debt, Equity Ratio, Chi-square test, T-test, Levene's test.

### 1. INTRODUCTION

Small and medium enterprise uses different type of financing source. The financial structure is mix of short-term and long-term sources. These sources are used for financing company's activities. In this way, the company formulates the way of financing the entire assets, so it has to have a certain amount of equity. Regarding this is very important managing the policy of capital structure taking into account the fact that capital structure includes management of own and borrowed long-term capital. When the company makes decisions about capital structure, it has to have also good management for investment, dividend policy and managing successful business strategy in the time of competitions.

New financial flows and the development of fin-tech are making up different rules of managing the structural of company's capital. The globalization brings new views and acting of managers for using financial sources and rise of the company. So, capital structure is linked with financial market development, market conditions, availability of debt, type of industry sector as the control of managers.

Capital structure in SMEs has different patterns for financial sources. The fact is that SMEs have limited options for financial sources available, thus making decisions by owner/managers in SMEs is different compared with large companies. Managers have the crucial role about making capital structure policy. The success of this policy depends from managerial characteristic, debt, legal form, financial conditions and market. The financial preferences and managing of the company will depend from development of financial market. This affects the level of indebtedness and financing cost. Also, Cook (2001) concluded that level of country's development will be evident in a capital structure of SME – higher level of long term assets, higher share of family and friend's money, difficult access to finance and lower net working capital and liquidity ratios.

### 2. LITERATURE REVIEW

Theories about capital structure were created in the time of domination of large companies. But after that period, the focus was on small and medium enterprises and its number were growing up very fast. So, researchers began to investigate how SMEs conduct the policy of capital structure according their limited source for financing.

For example, Walker and Petty (1978) analyze the difference between financial management in SMEs and big companies. Hamilton and Fox (1998) investigate that agency costs are not so big for making capital structure decisions in small and medium enterprises. This research is upgraded by Norton (1991), measuring the effect of asymmetric information on capital structure decisions in SMEs.

Belak (2015) analyze the optimal capital structure of the company. He concludes that optimum is the purpose of procedures that will led the company to catch the most effective economic position of the assets and capital structure. This author also underlines that in his opinion, the share of total liabilities to total assets should not be higher than 50%. Carpenter and Petersen (2002) analyze the impact of financing sources on company's growth and development. They said that it is very difficult for small companies to obtain external sources of financing at acceptable conditions for the owner/manager of the company, so they used internal sources like loans from owner, long-term provisions, retained earnings. Beck and Demircuc-Kunt (2006) analyze the link between SMEs and

irregularities that describe all underdeveloped financial market as access to sources of financing, legal protection and corruption.

There are researchers that investigate the determinants of structure capital. For example, Akdal (2010) concluded few determinants of capital structure decisions in UK as profitability, size, growth, tangible assets, liquidity and volatility. Determinants for capital structure in Macedonia are: size, growth, tangible assets, profitability, tax protection (2009). While in Greece and France the main determinants for capital structure in SMEs are size, growth, tangible assets and profitability (2008). SMEs in Netherlands examine these type of determinants-tangible assets, non-tangible assets, size, profitability, growth, tax rate, depreciation and they proved that leverage is positively related to size, tangible assets, growth and negatively to profitability (2010).

### **3. DETECTING FINANCIAL (CAPITAL) STRUCTURE OF THE SMES IN MACEDONIA**

Capital structure is linked with company's success. Measuring the profitability of the company is not enough due to the fact that there are cases where profitable company does bankrupt. That is the reason in this paper to analyze the financing performance and successful managing of the financial (capital) structure.

As it was mention in the previous part, owners/managers of the company are very important for making successful capital structure decisions. The impact of this is seen in diversification of financing sources and low costs towards credit institutions. At the end, the result is increased value assets of the SME. Creating good financial (capital) policy depends from managers' financial knowledge and they should use more information about available financing source, accounting for obtaining excellent business results.

For good financial (capital) structure decisions are needed few determinants. Those determinants are: characteristic of the managers, their control, expertise, knowledge, the debt of the company, as the internal and external factors. When we mention about external factors we think on market conditions, access to finance and legal form of the SME.

Financial literacy offers opinions that for making successful capital structure decisions, access to finance and managerial performance are the fundament. Other authors (Michaelas et al., 1998) investigate that culture and cultural differences have influence in capital structure of the SMEs.

There are many proposed models that explained the capital structure of the SME and managing it, but there is no universal formula for optimum capital structure. Companies with a capital ratio of less than 50% are riskier but also exposed to bankruptcy. Using the data from the state publications and the applied tests, the situation in Macedonia and the sampled sample will be determined in the next sections.

EU defines three SMEs' parameters: a) micro enterprises are companies with number of employees up to 10 people; b) small enterprises that employ up to 50 people; c) medium enterprises that have up to 250 employees.

The number of small and medium-sized enterprises in Macedonia, increased in the period from 1990 to the end of 1993, then decreased, and again strengthened after 1996. In 2001, as a consequence of the war, small and medium-sized enterprises were almost never formed, but their dynamics again strengthened in 2002. At the end of 2004 there were 172,297 small and medium enterprises registered in Macedonia. However, most of them were inactive enterprises, i.e. did not generate income, did not employ workers and did not make payments), and only 49 123 small and medium enterprises were active. At the beginning of 2012, there were 73 118 active enterprises in Macedonia, of which 72 933 (or 99, 7%) were small and medium enterprises. In addition, they had a dominant share in the formation of GDP (over 55%, in the added value), and in the total employment in the business sector (over 75%).

The European definition of SMEs explain that the category of micro, small and medium-sized enterprises (SMEs) is created by enterprises employing less than 250 people and having no annual turnover not exceeding 50 million euros and / or an annual balance sheet that doesn't exceed 43 million euros. In the non-financial sector of EU countries (EU-27), small and medium-sized enterprises account for as much as 99.8% in the total number of enterprises, while micro companies account for 91.8%. But small and medium-sized enterprises have a large share in employment within the business sector - in the non-financial sector of the EU-27, creating 67% of the total employment, as well as in the creation of added value - almost 58%.

In 2004, with the changes in the Law on Trade Companies, Macedonia accepted the methodology of the EU Commission for classification of enterprises by size. According to this methodology, based on three criteria (number of employees, size of turnover and total value of business assets), enterprises are classified into micro, small, medium and large. In addition, the first criterion of the methodology (number of employees) is applied in Macedonia (micro to 10 employees, small to 50 employees, medium to 250 employees and large over 250 employees), while the other two criteria are respectively reduced in the case of Macedonia. For example, in Macedonia, small enterprises are those with an annual turnover of up to 2 million euros, unlike the EU, where this amount is 10 million euros). If a company exceeds two of the above mentioned criteria it is classified into the category of medium-sized

enterprises. Micro enterprises are those who do not exceed the limit in two of the three conditions during the financial year.

#### 4. METHODOLOGY

The research uses financial data from State Statistic Office and Agency for Promotion of Entrepreneurship of the Republic of Macedonia. The sample count 97 small and medium enterprises obtained from annual financial statements disclosed for 2021 financial year. Analyzing the importance of the core variables, the research estimates equity ratio and long term debt to equity ratio. Equity ratio indicates the degree in which enterprises use their own assets for financing their activities. Equity ratio is measured as quotient of equity of the company and total assets. Because equity ratio is financial ratio, it is used to analyze financial structure. Long term debt to equity ratio is also financial ratio, and this ratio shows the choice of the company – does it use financing assets with long term creditor's assets or using its own sources. Long term debt to equity ratio is measured as quotient of long term liabilities and capital and helps to analyze capital structure. Also, the companies are divided in companies which have opened bankruptcy proceeding in 2021 and companies which haven't opened bankruptcy proceeding in 2021. The analysis of the survey is done by Chi-square test, T-test and Levene's test for equality of variances.

#### Analysis, results and discussion

Companies with a capital ratio of less than 50% are riskier but also exposed to bankruptcy. Using the data from the state publications and the applied tests, the situation in Macedonia and the sampled sample will be determined.

**Table 1. Bankruptcy, Equity ratio, Long-term debt to equity ratio**

		Equity ratio		Total	LTD/E		Total
		<50%	>50%		Higher LTD	Higher E	
Bankruptcy	Bankrupted	33	1	34	33	10	43
	Non-bankrupted	16	32	48	5	38	43
Total		49	33	82	38	48	86

Source: Author's calculation

The results of the Table 1 show that there is a link between bankruptcy and capital structure, as the link between bankruptcy and financial structure. Table 1 also expresses that the most part of the companies have equity ratio higher than 50% meaning that those are not-bankrupted. Total percentage of the sample expresses the same conclusion.

When the focus is on the second half of the table (LTD/E), almost 81% of the companies with higher capital than LTD haven't opened bankruptcy proceeding. Also, there is a big percentage of companies that show higher LTD than capital have opened bankruptcy proceeding (86%).

**Table 2. Chi-square test**

	Equity ratio					LTD/Equity ratio				
	Value	df	Asymp. Sig.	Exact Sig. (2-sided)	Exact Sig. (1-sided)	Value	df	Asymp. Sig.	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	31,39	1	0,001			35,88	1	0,001		
Fisher's Exact Test				0,001	0,001				0,001	0,001
Likelihood Ratio	39,44	1	0,001			40,85	1	0,001		
Continuity Correction	28,64	1	0,001			35,15	1	0,001		
Linear-by-Linear Association	30,93	1	0,001			35,42	1	0,001		
N of Valid Cases	82					86				

Source: Author's calculation

Table 2 indicates that relations between capital structure and open bankruptcy proceeding and relation between financial structure and open bankruptcy proceeding, are statistically significant. The analysis of the survey continues with T-test and Levene's test for equality of variances.

**Table 3. T-test and Levene's test for equality of variances.**

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	t	df	Sig.(2-tailed)	Mean difference	Std. Error difference	95% Confidence Interval of the Difference	
									Lower	Upper
Financial Structure	EVA <sup>a</sup>	8.158	0.005	-1.28	80	0.161	-159.67	178.28	-624.01	113.39
	EVNA <sup>b</sup>			-0.83	18	0.349	-159.67	268.26	-819.76	300.22
Capital Structure	EVA <sup>a</sup>	1.63	0.18	0.63	80	0.36	0.63	1.00	-1.15	2.61
	EVNA <sup>b</sup>			0.49	25	0.46	0.63	1.25	-1.70	3.16

Source: Author's calculation

<sup>a</sup>EVA – Equal Variances Assumed

<sup>b</sup>EVNA – Equal Variances Not Assumed

According T-test for Equality of Means and Levene's Test for Equality of Variances applied in Table 3 could be seen that between equity ratios of SMEs which belong to manufacturing or retail/wholesale business activities, there is statistically significant difference. Also, between LTD to Equity ratio of SME, there is no significant difference.

## 5. CONCLUSION

Capital structure is linked with company's success. Measuring the profitability of the company is not enough due to the fact that there are cases where profitable company does bankrupt. That is the reason in this paper to analyze the financing performance and successful managing of the financial (capital) structure.

Managing the policy of capital structure takes into account the fact that capital structure includes management of own and borrowed long-term capital.

From the values obtain in applied tests, could be concluded that financial and capital structure of the SME are significantly associated with the opening of bankruptcy proceedings. These kinds of SMEs are associated with high levels of debt and low capitals level. SME which has continuous business activity uses own resource for financing and it is more of the half of their assets value. Also this was confirmed from the above tests that there is statistically significant difference regarding financial and capital structure.

Having successful capital structure policy means that owner/manager of the SME must have to intensify the purpose – achieving optimal investments. Owners/managers of the SMEs have to use strategic management in ensuring continuous business activities, upgrading the value of the SME thus increasing the competitiveness. Also, very crucial thing is using different kind of financial sources but in the same adequate of the size and business activity of the company, as the market condition where company acts.

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