International Journal of Economics, Commerce and Management
United Kingdom Vol. III, Issue 2, Feb 2015
http://ijecm.co.uk/ ISSN 2348 0386

FINANCIAL STRATEGIES OF ALBANIAN COMPANIES

Klaudeta Merollari
Department of Finance-Accounting, Faculty of Economy, Fan S. Noli University, Korçë, Albania
klaudetamerollari2010@hotmail.com

Arben Kambo
Fan S. Noli University, Korçë, Albania
kambo.arben@yahoo.com

Abstract

After the fall of the communist regime, Albania has gone through a process of economic and social changes. Obviously in this broad and universal process, the companies were focused on the problems they have encountered in finding financial funds. In Albania, as in other developing countries, companies have encountered problems in finding funding sources. Developing countries face lack of financial resources, they are also characterized by problems related to the functioning of financial markets. Therefore, the main aim of this study is to analyze strategies linked with funding of Albanian companies. It is obvious that companies have a certain optimal financial structure and try to go towards that. Enterprises have long – term goals about the debt. The ideas according to which companies make their financial choices in accordance to a target indicator derive from the financial analysis that uses sectional averages to assess the financial situation of enterprises.

Keywords: funding of companies, financial structure, debt indicator, financial strategies

INTRODUCTION

After the ’90-s in Albania flourished the free market economy, and were created the first private businesses and then the first companies. Companies needed financial sources since at the very beginning and later on in order to finance their growth, to finance investments on fixed assets, long term projects etc. Albanian companies often face difficulties in finding funding sources. Albania does not suffer from the lack of capital but from the lack of its effective use. This because capital reserves per capita deposited in banking system are higher compared to some

other post-communist Balkan countries. The capital deposited in Albanian banking system is invested in domestic business in a lower level compared to other Balkan countries. Albania posses a high trade deficit because of the low level of credit. The effective use of capital would influence this deficit.

The main aim of this study is to provide that there is a link between certain factors and the company's debt. The methodology of research has played a special role on this research paper; it has served as a safe base and clear orientation in the conception phase, methodological elaboration, and empirical work that summarizes this paper. There steps are followed: *First phase: Selection of literature*_this step consists of reviewing the literature related to the object of study. It includes the study of books, articles, international and national conference proceedings etc. *Second phase: Data collection*_includes collecting data on potential factors that influence the total financial debt indicator. We have got them from financial statements of shareholding companies operating in Albania. *Third phase: data analyses*_for the successful implementation of this study we are based on the method of analysis and synthesis as well as on analysis of secondary data. The analysis was conducted with the support of SPSS software program and special statistical methods such as multiple linear regressions.

LITERATURE REVIEW

In order to understand the capital structures, most studies realise transversal cutting, which raise hypothesis that the companies reach and maintain optimal amount of debt. Shyam-Sunder and Myers views as well as Fama and French analyze financing choices in a dynamic short-term perspective. Preoccupation to study the long-term evolution is not missing but studies in general are realised in a more summarized way.

Fama and French as well as Opler and Titman have empirically verified the process of debt returning to a target level. Enterprises have long-term goals about the debt. This classical model provides results in accordance with those achieved by Rajan and Zingales with a comparable model: profitability is negatively related to debt and is the only variable which effect is always significant.

In a second stage Fama and French have explained the modification of debt between t and t + 2 with an obvious difference in time “t” between debt and intent, as well as a vector of other variables, of which none is significant. When the coefficient of distance variable in relation to its aim is significant, the authors confirm that enterprises tend to bring their debt back to the set.

Opler and Titman show that enterprises are able to issue debt when their debt is lower than the target, and when they are rentable. The method of assessing indicators is similar to

that used by Fama and French, although the amount of debt is different. The results confirm that the company takes the funding decisions in order to get close to the target level of debt. Opler and Titman also show that enterprises have been rentable in their recent past, and are more likely to issue debt rather than their capital. This enterprise management in relation to funding does not seem special to American enterprises. Remonola shows that from 1983-1988, in four US states; enterprises managed their long-term debts in order to achieve an optimal capital.

Definition of Target Indicators

The idea according to which companies make their financial choices in accordance to a target indicator derives from the practice of financial analysis that uses sectional averages to assess the financial situation of enterprises. According to Shyam-Sunder and Myers, the notion of target indicators can be part of the theory: Static Trade-off Theory, according to which the optimal level of debt is achieved when the marginal economy that comes from the use of debt is cancelled by the increased potential costs of bankruptcy. Although the principles are clear the concrete definition of optimal debt and the formulation of hypothesis related to the defined factors of target indicators, remains fragile. This justifies the use of empirical studies. Harris and Raviv summarize the results of such studies as follows: "debt increases with tangible assets, other fiscal benefits from interests and enterprise growth opportunities; debt is reduced by risk, by the probability of bankruptcy and the profitability. Assume that enterprises effectively determine a target indicator but avert it periodically and significantly, then approach it again under the influence of factors generally associated with the conceptual framework of the Pecking Order Theory. In this framework the target indicator can be defined as a permanent average of debt indicator.

Deviation from Target Indicator and Pecking Order Theory

The optimum level can be changed for different reasons such as: investments, weak profitability, significant emissions etc. and these changes may continuo for long periods of time. In a world where adjustment costs are not zero, the company that manages its debt under a target indicator, faces fixed costs of issuing debt and own capital. For every fiscal period the enterprise generates cash and completely or partly uses it to its growth. In periods of high profitability and low growth, the company will generate liquidity and must demonstrate (to have) a debt indicator lower than the target index. The opposite situation will prevail when we will have a weak profitability and a rapid growth. The difference between profitability and growth, in percentage, is a factor which explains the difference between the real debt and the target debt. Goffin (1998) illustrates the continuous overstock and shortfalls in terms of external financing,

which is linked to the phases of economic circumstances. The fast disappearance of these changes should be related to the willingness of leaders to carry out the necessary emissions. This may be related to regrouped factors under the Pecking Order Theory, in which executives favour the less sensitive financial tools to imperfect information, and prefer self-financing against the debt and perform the issuance of shares at the end. Financing by issuing stock can be very costly because of the asymmetry and attitude of managers. If we do not refer to the conceptual framework of the Pecking Order Theory, these differences between the real debt and the target debt in principle should not last long (short term). In fact, in the case of the lack of information asymmetry, the enterprise is indifferent to the financing manners and will complement the difference between target and actual debt, once the costs of emission would seem reasonable in relation to the importance of holding the target debt.

However, under the Pecking Order Theory, the difference between the real and the target debt may take a more permanent character, especially when the debt indicator exceeds the target indicator, because of the lack of fund shares. Close relations can be predicted between the break even in one hand and the debt on the other. In addition, self-financing capacity should play a major role in the adjustment process of the observed indicators toward target indicators (Myers, 1993).

Finally accepting the conceptual framework of Pecking Order Theory, leads to acceptance of an asymmetry in financial behaviour. This analysis scheme is coherent to the results of many empirical studies which show that the strongest evidence that opposes Static Trade-off Theory is a strong inverse link between profitability and debt (Myers 1993, page 98). Debt selection criteria in enterprises are leaded by the existence of an optimal target indicator in a long term period. Some authors like Fama and French, Remonola, integrate two theoretical frameworks of Static Trade-off Theory and Pecking Order Theory. To explain why enterprises temporarily change their indicators we can refer to the asymmetry of information that serves as a support for the Pecking Order Theory.

RESEARCH METHODOLOGY

For shareholding companies operating in Albania we intend to discover some factors that influence the company's debt indicator. Based also on the scientific researches of foreign experts we have raised the following hypothesis:

Several factors influence the policy of the debt of company.

To check whether the identified variables actually affect the policy of the company's debt it is used multiple linear regressions with the smallest ordinary squares.

The model is expressed as follows:

$$Y_i = \beta_0 + \beta_1 profitability_i + \beta_2 growth_i + \beta_3 distance_i + \beta_4 the\ need\ for\ circulating\ funds_i + \beta_5 percentage\ of\ gross\ investment_i + \varepsilon_i$$

The dependent variable $\mathbf{Y_i}$ is the change in total financial debt indicator of enterprise **i**. Independent variables are calculated from the financial statements of some shareholding companies, operating in Albania, in a 10 years period (2004-2013).

The equation expresses the relation between the dependent variable, the total financial debt indicator, which is measured by the total debt ratio to total assets, and other independent variables that are:

- Profitability of the company
- Increasing the Company
- The distance from target debt indicator
- The need for floating funds (NFF)
- Gross investment

Hypotheses that we should prove are:

$H_{0:}$ $\beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = \beta_7 = 0$

$H_{1:}$ At least one of the above parameters is different from zero.

Data collection and processing

In financial statements of shareholding companies that operate in Albania we have found data on potential factors that influence the total financial debt indicator. To test our hypotheses we used the five above mentioned factors.

Table 1: The design of the model

VARIABLES	Definition
Profitability	Average profitability of last 10 fiscal years ∑ EBIT/ ∑ total assets (10 years)
Growth	Percentage of growth in ten years (Total assets in year 10/ Total assets in the first year) - 1
Distance	The distance variable between the beginning of period (year 1) and sectional average for the entire period. The index of the total financial debt at the beginning - the average over the 10 years of this indicator for all sector enterprises presented in the sample.
Need for floating funds (NFF)	The need for floating funds / turnover figures (average 10 years) [Inventory + receivable- payables] / Total net sales or revenues (average 10 years)
% of gross investment (GI)	Percentage of gross investment

This is a quantitative analysis because the five independent variables are quantitative. Analyses were conducted with the help of SPSS program and special statistical methods such as multiple linear regressions.

EMPIRICAL RESULTS

As a result we take a multiple linear regression model for the five variables with defined coefficient 1 and defined corrected coefficient 0.999. This means that 99.9% of the company's debt policies are explained by the linear dependence of the five variables. The obtained results are presented in the following table. The table shows the results of the test "t" in relation to the characteristics of the impact of independent variables on debt indicator.

Table 2: Results of multiple linear regressions

Summary of the model				
Model	R	Squared R	Corrected squared R	Std. Error of the Estimate
1	1.000[a]	1.000	.999	.0011258

a. Predictors: (Constant), GI, Profitability, Growth, NFF, Distance

Control on the importance of connectivity

According to Fisher the value "F" is 2901,040 which means bigger than critical value. This fact demolishes the hypothesis H0 and automatically accepts as true the hypothesis H1. According to Fisher's test we proved that between the independent variables, the financial debt indicator, and five different variables, there is an important link, at least one of the parameters, β, is different from 0.

Table 3: Control on the importance of connectivity

ANOVA[b]

Model		Sum of squares	df	Mean Square	F	Sig.
1	Regression	.018	5	.004	2901.040	.000[a]
	Residual	.000	4	.000		
	Total	.018	9			

a. Predictors: (Constant), GI, Profitability, Growth, NFF, Distance

b. Dependent Variable: DR

"t" criteria for the evaluation of the importance of individual parameters

It is necessary to make another control in order to assess which of the parameters (beta) is more important. To control the importance of individual parameters we use as a statistical method the criterion "t". By comparing the values of "t" calculated from the table below, with

critical "t" for α = 0,05 it results that the factors which mostly affect the debt are: distance from target indicator, profitability, need for floating funds, gross investments, while the company's increase has little impact.

Table 4: The evaluation of the importance of individual parameters

Coefficients[a]

Model	Non-standardized coefficients		Standardized coefficients			95.0% Confidence Interval for B	
	B	Std. Error	Beta	t	Sig.	Lower Bound	Upper Bound
(Constant)	.433	.007		62.554	.000	.414	.452
Profitability	-.076	.024	-.038	-3.139	.035	-.144	-.009
Growth	.001	.001	.012	.912	.314	-.003	.005
Distance	.917	.018	.948	50.200	.000	.867	.968
NFF	.002	.001	.037	2.059	.109	-.001	.006
GI	.001	.001	.013	1.205	.194	-.001	.003

a. Dependent Variable: DR (Dependant variable, Financial Debt Ratio)

The equation that we get is:

Y = 0.433 – 0.076 x profitability + 0.001 x growth + 0.917 x distance + 0.002 x NFF + 0.001 x GI + ε

Signs of regression coefficients comply with financial logic, which in this case means:

- An increase with a unit in gross investment, affects the increase of debt ratio with 0.001 units, when all other variables remain constant.
- An increase in the need for floating funds with a unit affects the increase of debt ratio with 0,002 units, when all other variables remain constant.
- An increase in the distance from the target debt indicator with a unit, affects the increase of debt ratio with 0,917 units, when all other variables remain constant.
- An increase in the growth of companies with a unit increases the debt ratio to 0.001 units, when all other variables remain constant.
- An increase with a unit in the profitability influences the decrease of the debt ratio to 0,076 units, when all other variables remain constant.

CONCLUSION

This study examines the relationship between several independent variables (profitability, increase, the need for revolving funds, the gross investment rate, and the distance from the target indicator) with the dependent variable (the ratio of financial debt) in Albanian companies. The results prove the existence of a significant relationship between the independent variables

and the dependent ones. The independent variable that has the greatest impact on the debt ratio is the distance from the target indicator. This means that the distance between the financial debt ratio and the target debt indicator, influences directly the tendency of the company to borrow and vice versa.

However, despite of the ability of the used methodology to test these facts, the results cannot be considered definitive. The sample of our study was relatively small (only shareholding Companies Operating in Albania), we should also consider the informality of Albanian businesses, and in default of sector averages in Albania, we have used the concept of optimal structure of 40% debt ratio. All independent variables of this study are quantitative; in the future this study may be completed by possible independent qualitative variables. This can be an interesting field of study for further research.

REFERENCES

Fama E. French K. 1997 "*Industry costs of equity*" Journal of Financial Economics, Vol.43

Harris, M. and Raviv A. 1991 "*The Theory of Capital Structure*" Journal of Finance, Vol.46 f.334

Oloumi Z.1997, Universite de Nice-Sophia Antipolis. "*Problemes de financement d' une entreprise dans les PED"*

Opler T. and Titman Sh.1996 "*The Debt- Equity Choice: An Empirical Analysis*" Corporate Finance And Organizations

Rajan and Zingales 1995 "*What Do We Know About Capital Structure? Some Evidence From International Data*" Journal of Finance, Vol.50 No.5

Remonola E. M 1990 "*Understanding international differences in leverage trends*" Federal Reserve Bank of New York

Shyam- Sunder L. and Myers, 1999 "*Testing Static Trade off Against Pecing Order Models of Capital Structure*" Journal of Financial Economics, Vol.51

Titman Sh. and Tsyplakov S. 2007. "*A Dynamic Model of Optimal Capital Structure,"* Review of Finance, European Finance Association, vol. 11(3), pages 401-451.