

THE CAPITAL STRUCTURE DETERMINANTS IN TRADE OF SERBIA

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Abstract

In order to efficiently manage and optimize the capital structure, as a function of achieving the goal performance of the company, it is necessary to know its determinants. There are general and determinants specific to the nature of each company. This paper explores the determinants of capital structure in trading companies in Serbia. In that context internal determinants of the capital structure in trade of Serbia for the period 2008-2013 are specially researched. Their positive and negative effects are important for optimizing the capital structure, as significant determinant, in order to achieve the targeted total performance of the trade in Serbia in the future.

Keywords: Determinants, Theory of the capital structure, Financial leverage, Performance, Trade in Serbia.

1. INTRODUCTION

There are numerous determinants of the capital structure in trade companies. Typical are: the growth opportunity (assets and sales growth), profitability, structure of assets, business risk, tax shield, liquidity, the analysis of capital structure and technology (Abdou et al. 2012). The capital structure of trade companies is also affected by other factors, above all factors of external nature, like specific industrial determinants (industrial leverage, industrial growth) and macroeconomic determinants (inflation, GDP growth, capital flows, tax shield) (Köksal, 2014; Kühnhausen, 2014). Nevertheless numerous internal and external factors affect the capital structure of companies the issue of this analysis are only specific determinants of capital structure in a function of its optimization and improvement of overall performance of trade in Serbia.

The aim of this work is thorough analysis of the capital structure determinants in trade of Serbia. The knowledge of the intensity of their positive or negative effect is very significant for trade managers concerning the establishing optimal capital structure (with efficient financial management) in a function of meeting target performance on the level of single trade company and the trade as a whole. In that we find the scientific and professional contribution of this work.

As it is known, extensive literature is dedicated to the general theoretical and practical analysis of the

factors of capital structure, i.e. impact of financial leverage on performance (liquidity and profitability) of companies (Köksal, 2014; De Luca, 2014). Special attention is recently paid to the analysis of specific determinants of capital structure, as well as the impact of financial leverage on companies' performance in particular economy sectors, including trade.

Nevertheless, a few specialised, especially complete, works were written on the subject: specific determinants of capital structure and impact of financial leverage on performance of trade companies (wholesale and/or retail). This issue is partly observed in the context of general research of the specifics and importance of financial strategies in trade companies (Van der Wijst, 1993; Gill et al. 2009; Evans, 2005; Little et al. 2011; Kamath, 2013; Li et al. 2014; Lee, 2014; Moatti et al. 2014; Chevalier, 1995; McGloldrick, 2002; Levy, 2007; Berman, 2010; Yu, 2014). Lately, concerning thorough research of this subject the work of the following authors is known (Chevalier, 1995; Gleason, 2000; Gill, 2009; Abdou, 2012; Ajanthan, 2013; Anhin, 2014; Hilgen, 2014; Kaya, 2014; Lee, 2014).

To our knowledge, there is no paper in Serbia and wider, fully dedicated to the research of specificity of the capital structure factors and the impact of financial leverage, as measures of financial risk on the performance of the trading companies in Serbia. These issues are partly researched in work of the following authors: (Lovreta, 2011; Luki , 2011, 2012, 2013a b, 2014a b c d, 2015 a,b,c,d,e). This gap should be to some extent sealed with this work, which content and methodology of the treated problems should provide an adequate basis for efficient management of financial leverage, in accordance with the theory of capital structure, and total finance in order to improve the performance of trading companies in Serbia in the future. In this our work finds its scientific and professional contribution. Concerning its significance and complexity of the treated issues we will test the following hypotheses in this work by the application of adequate methodology, based on original empirical data for trade of Serbia in period 2008-2013. These are: – there is a positive correlation between the leverage ratio and growth; – there is a positive correlation between the leverage ratio and size; – there is a negative correlation between the leverage ratio and profitability; – there is a positive correlation between leverage ratio and assets structure; – there is a negative correlation between the leverage ratio and business risk; – there is a negative correlation between the leverage ratio and depreciation ratio (expressed in percents of sale); – there is a negative correlation between the leverage ratio and liquidity; – there is significant impact of profitability, physical assets, size and growth on leverage ratio.

According to the aim of the work and defined hypotheses, the methodology of the research is based on ratio analysis and application of statistical analysis. We also used comparative analysis of the capital structure theory to a necessary extent and also researched vast literature to treat the general issues.

To conduct this research we used original empirical data concerning trade of Serbia in period 2008-2013, collected primarily from Business registers agency. The sample consists of huge number of trade companies which are obliged to submit annual financial reports to the Business register agency. For the sake of illustration, the number of included trade companies in 2013 was 33.341; see: Table 4).

2. THEORETICAL FRAMEWORK AND SPECIFIC DIMENSIONS OF CAPITAL STRUCTURE IN TRADE

Generally speaking, the term capital structure - financial leverage defines the relation between alien and own sources of funding, i.e. debt financing of concrete types of assets. Debt financing of company's business has its own advantages and disadvantages.

The benefits of debt financing instead of raising funds by issuing shares are tax reliefs and stimulation of managers to involve discipline in making investment decisions. Weaknesses are: expectation of increased bankruptcy costs, conflicts between shareholders and creditors, and reduction of flexibility of gaining additional financing in the future. In principle, if the marginal utility is greater than marginal cost, the company should get into debt. In all other cases, the company should issue its own shares (Damodaran, 2007).

The analysis of the impact of financial leverage on the performance of trading companies in this paper is based on the theory of capital structure (Brealey, 2007; Van Horne, 2007; Abdou et al., 2012; Kühnhausen, 2014). Two major theories of capital structure are: trade-off theory and the theory of the hierarchy.

According to the trade-off theory, which main creators are Modigliani and Miller (1958, 1963) the formation of capital structure is influenced by: the tax shield, the market value of the company and the costs of capital.

According to Jensen and Meckling (1976) and Myers (1977), the creation of capital structure, beside these factors, is also affected by: costs of bankruptcy and financial troubles and agency costs, respectively.

According to the theory of hierarchy (pecking-order theory), which is advocated by Myers and Majluf (1984), the perception of the order of financing is as follows: internal financing, debt financing and issuing of shares. It is empirically proven that the theory of hierarchy is more applied in trading companies. It is in accordance with the character of their business, treated as a special important determinant of capital structure (Degryse, 2012).

The capital structure affects the financial performance of the company. The negative relationship between capital structure and financial performance indicates that agency problems lead to use debt more than it is needed in the capital structure, what produces poorer performance (Gleason, 2000). Each company, including trading, tends to the optimal capital structure in achieving profit and other goals. In principle, the optimal capital structure is realized in maximizing the company's value by minimizing the costs of capital. This is in accordance with - the theory of static compromise - which is now the prevailing theory of capital structure. Table 1 presents the general diverse effects of internal determinants of leverage according to the trade-off theory and the theory of the hierarchy.

TABLE 1 THEORIES OF CAPITAL STRUCTURE AND THE RELATIONSHIP BETWEEN LEVERAGE AND INTERNAL DETERMINANTS

Determinants	Theories	
	The theory of hierarchy	Trade-off theory
Profitability	Negative	Positive
Size	Negative	Positive
Growth	Positive	Negative
Assets - tangible	Positive	Negative

Source: Ajanthan, 2013

3. THE GENERAL CHARACTERISTICS OF CAPITAL STRUCTURE IN TRADE OF SERBIA

Before we start the analysis of the capital structure determinants in trade of Serbia, we will shortly turn back on its general characteristics. Table 2 and figure 1 show the owner's assets ratio and interest coverage ratio for economy as a whole and per selective economy sectors, including trade for 2012 and 2013.

TABLE 2 OWNER'S ASSETS RATIO AND INTEREST COVERAGE RATIO IN TRADE OF SERBIA, 2012 AND 2013

	Owner's assets ratio		Interest coverage ratio	
	2013	2012	2013	2012
Companies - total	36.6	37.3	1.21	0.39
Agriculture, forestry, and fishing	46.5	42.3	3.46	1.69
Processing industry	23.3	24.5	0.18	1.14
Construction	35.3	36.0	-0.22	-2.31
Wholesale and retail ...	22.8	22.2	2.34	1.30
Financial and insurance business	47.5	51.8	-4.30	-4.66

Note: Owner's assets ratio – share of owner's capital in total capital which size is dictated by need of assets financing and effects of financial leverage. Interest coverage ratio – the ratio of net result and paid interests on one side and paid interest on the other.

Source: Business registers agency

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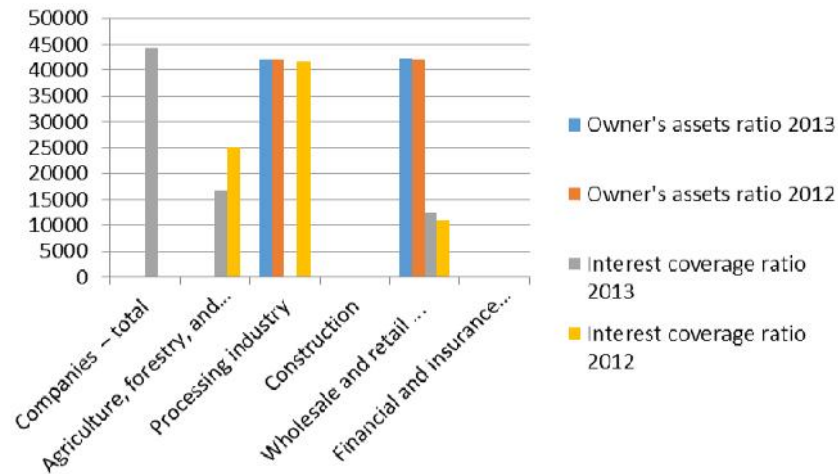


FIGURE 1 – RATIO OF OWN FUNDS AND INTEREST COVERAGE RATIO FOR THE ECONOMY AS A WHOLE AND BY SELECTIVE ECONOMIC SECTORS, INCLUDING TRADE, IN 2012 AND 2013
Source: Author's figure (table 2)

The data in the given table clearly show that the share of owner's in total capital in 2013 was the lowest in trade compared to economy as a whole, and compared to other sectors. In other words, it means that it is highly indebted, what is also shown by interest coverage ratio. It reflected on its overall performance.

Table 3 shows the calculation of dependent and independent variables used in this work during general, and especially, statistical analysis of the capital structure determinants in trade of Serbia.

TABLE 3 THE CALCULATION OF DEPENDENT AND INDEPENDENT VARIABLES

Variables	Formula
Dependent variable	
Y debt ratio (leverage)	Total liabilities / Total assets
Independent variables	
X1 Current liquidity	Current assets / Current liabilities
X2 Quick liquidity	Current assets – Inventory / Current liabilities
X3 Return on revenue	Net income / Business revenues
X4 Return on assets	Net income / Total assets
X5 Assets growth	Total assets (t) – Total assets (t-1) / Total assets (t-1)
X6 Assets structure	Fix assets / Total assets
X7 Firm growth – revenue percent change	Business revenues (t) – Business revenues (t-1) / Business revenues (t-1)
X8 Firm size	Log 10 – business revenues
X9 Business risk	Standard deviation of annual net income for six years / Average net income for six years
X10 Gross operating surplus – depreciation (in percents) from revenues	Gross operating surplus – depreciation / Business revenues
X11 Assets turnover	Business revenues / Assets
X12 Return on equity	Business revenues / Shareholders capital

Note: Author's calculation based on literature research

Methodologically observed, financial leverage can be expressed in different ways. Typical are: short-term leverage = short-term debt / total assets; long-term leverage = long-term debt / total assets; total leverage = total debt / total assets.

In the context of strategic profit model, based on DuPont analysis, financial leverage is presented as: financial leverage = total assets / total shareholders' equity. This way of presenting financial leverage is widely used in trade companies, especially within the strategic profit model, which is widely used as an instrument of financial management.

Table 4 and Figure 2 summarize the initial variables showed in Table 3. as required by statistical analysis of capital structure determinants in trade of Serbia for 2008 – 2013 period. Given variables are also indicative of general characteristics of trade performances in Serbia. So, for example, financial indebtedness in observed period increased from year to year, except in 2012. It is high compared to trade in countries of developed market economies and the "industry standards". Liquidity is also unsatisfactory compared to golden bank rules (2 : 1), especially in 2013. The profitability, envisaged through the prism of business revenues, is unsatisfactory because it decreased from year to year in the observed period, due to low consumer buying power. Low buying power, beside high unemployment and other unfavourable business conditions, has also negatively reflected on other performance measures.

TABLE 4 CAPITAL STRUCTURE DETERMINANTS IN TRADE OF SERBIA

	2008	2009	2010	2011	2012	2013
Number of companies	37,077	34,982	35,474	33,451	33,393	33,341
Financial leverage	0,616	0,631	0,708	0,686	0,622	0,683
Current liquidity	1,037	1,004	1,003	1,006	1,017	0,995
Quick liquidity	0,682	0,677	0,669	0,662	0,661	0,661
Return on revenue	3,59	3,30	3,23	3,40	3,09	3,10
Return on assets	4,04	3,36	3,87	4,25	3,94	3,72
Assets growth	14,10	5,03	-5,73	3,47	9,30	1,93
Assets structure	46,75	45,74	35,37	33,02	33,05	33,02
Firm growth – revenue percent change	19,29	-5,13	11,23	7,73	11,47	-4,05
Firm size	9,373	9,350	9,397	9,429	9,429	9,476
Business risk	0,992	0,866	0,942	1,070	1,084	1,044
Gross operating surplus – depreciation (in percents) from revenues	6,029	5,467	5,570	4,474	5,175	5,020
Assets turnover	1,125	1,016	1,199	1,249	1,273	1,222
Return on equity	10,66	9,23	13,53	13,78	13,15	12,02

Note: Author's calculation

Source: Business registers agency and Statistical Yearbook of Serbia

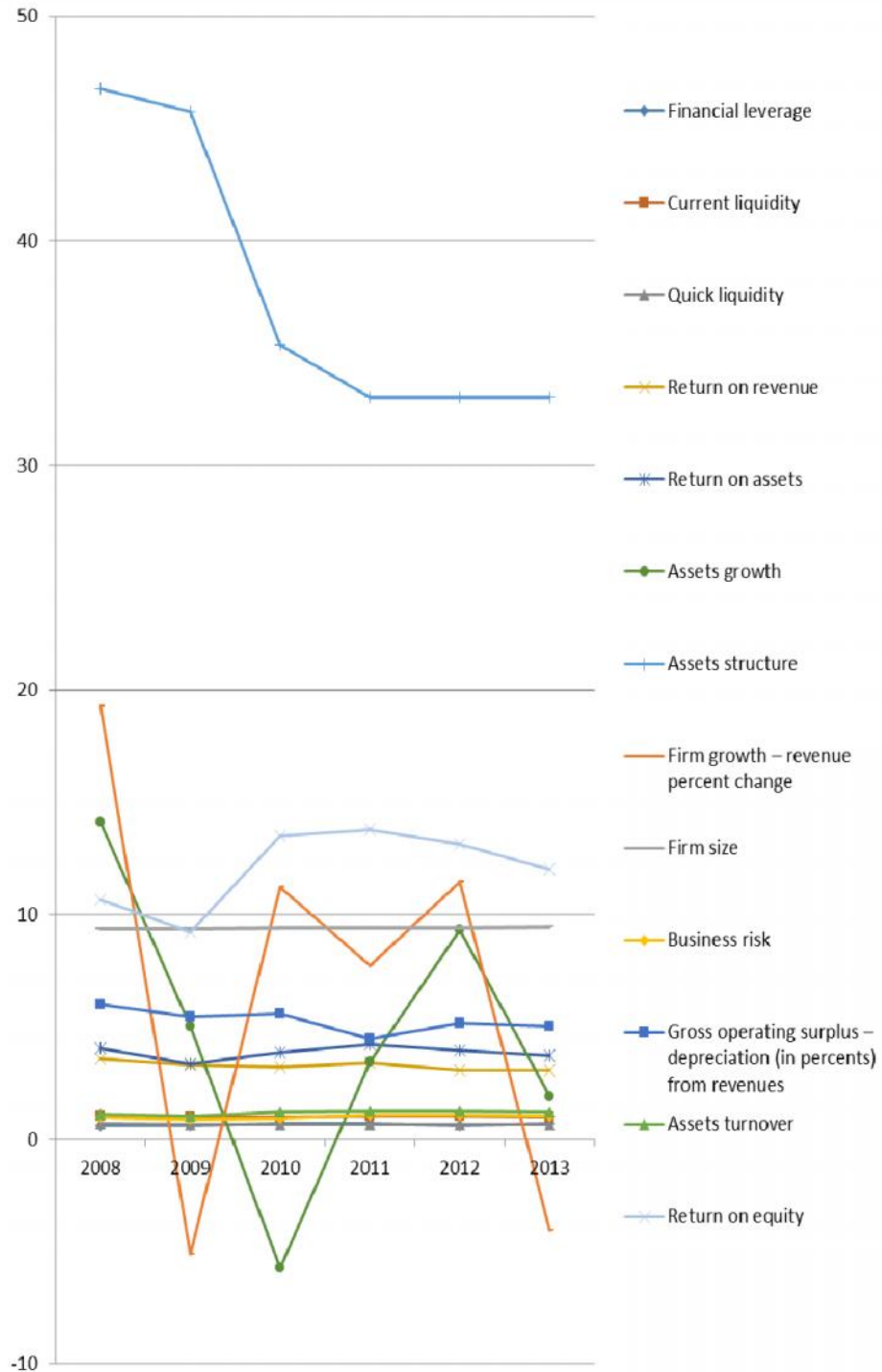


FIGURE 2 – CAPITAL STRUCTURE DETERMINANTS IN TRADE OF SERBIA
Source: Author's figure (table 4)

4. THE STATISTICAL ANALYSIS CAPITAL STRUCTURE DETERMINANTS IN TRADE OF SERBIA

TABLE 5 SHOWS THE DESCRIPTIVE STATISTICS OF ANALYSED PERFORMANCE INDICATORS, I.E. CAPITAL STRUCTURE DETERMINANTS IN TRADE OF SERBIA FOR THE PERIOD 2008 – 2013

Table 5 Descriptive Statistics (of analysed capital structure determinants in trade of Serbia)					
	N	Minimum	Maximum	Mean	Std. Deviation
Financial leverage	6	,62	,71	,6577	,03924
Current liquidity	6	1,00	1,04	1,0103	,01485
Quick liquidity	6	,66	,68	,6687	,00905
Return on revenue	6	3,09	3,59	3,2850	,19066
Return on assets	6	3,36	4,25	3,8633	,30349
Assets growth	6	-5,73	14,10	4,6833	6,74682
Assets structure	6	33,02	46,75	37,8250	6,59252
Firm growth – revenue percent change	6	-5,13	19,29	6,7567	9,57429
Firm size	6	9,35	9,48	9,4090	,04519
Business risk	6	,87	1,08	,9997	,08399
Gross operating surplus – depreciation (in percents) from revenues	6	4,47	6,03	5,2892	,53063
Assets turnover	6	1,02	1,27	1,1807	,09534
Return on equity	6	9,23	13,78	12,0617	1,80432
Valid N (listwise)	6				

Note: Author's calculation with application of SPSS software

As the results of the descriptive statistics show, in the given period the average values of some indicators were: financial leverage 0,65; current liquidity 1,01; return on revenue 3,28; firm growth – revenue percent change 6,75; firm size 9,40. Generally speaking, their value was lower compared to the trade of countries with developed market economies and „industry standards“. They were affected by negative business conditions, high bank costs, unfavourable exchange rates, low buying power.

Table 6. shows correlation analysis of capital structure determinants in trade of Serbia.

As the results of correlation analysis show, the impact of some analysed determinants on financial leverage in trade of Serbia is different. Some influenced positively while others negatively. The significant negative influence on financial leverage had following determinants: current liquidity, assets growth and assets structure, and positive – return on equity. Other determinants, positively and negatively, more or less moderately influenced financial leverage. According to the correlation coefficient of assets growth and assets structure, the application of modern technology, in the tradition of the countries with developed market economies, had significant influence on financial leverage in trade of Serbia. It will significantly improve the overall performance of trade in Serbia in the future (Shin,

2014). The similar situation is with the application of the concept of sustainable development (Phillips, 2010).

TABLE 6 CORRELATION ANALYSIS BETWEEN DETERMINANTS AND FINANCIAL LEVERAGE IN TRADE OF SERBIA

	Financial leverage Pearson Correlation	Sig. (2-tailed)	N
Financial leverage	1		6
Current liquidity	-,707	,116	6
Quick liquidity	-,491	,323	6
Return on revenue	-,277	,596	6
Return on assets	,185	,726	6
Assets growth	-,902*	,014	6
Assets structure	-,614	,195	6
Firm growth – revenue percent change	-,210	,690	6
Firm size	,453	,366	6
Business risk	,066	,901	6
Gross operating surplus – depreciation (in percents) from revenues	-,454	,366	6
Assets turnover	,392	,443	6
Return on equity	,612	,197	6

*. Correlation is significant at the 0.05 level (2-tailed).

Note: Authors calculation with application of SPSS software

Average values of selected capital structure determinants in trade of Serbia (Current liquidity, Return on revenue, Firm growth – revenue percent change and Firm size) are lower compared to the same values of the countries of the developed market economies and “industry standards” (see: Table 5). Unfavourable business conditions were the reason of that trend.

The results of correlation analysis show that current liquidity has significant negative influence on financial leverage in trade of Serbia. Return on revenue and firm growth - revenue percent change has moderate negative influence on financial leverage. Firm size has moderate positive effect on financial leverage (see: Table 6).

Given results of the regression model clearly show that single selected determinants (Current liquidity, Return on revenue, Firm growth – revenue percent change and Firm size)) do not affect significantly the capital structure of trade in Serbia (Sig. > 0,05). In total, as multiple regression coefficient shows, that is concerted coefficient of determination, they significantly affect (with 83%) the capital structure of trade in Serbia (R Square ,966; Adjusted R Square ,829; F ,829 Sig. ,274) . Considering such results of regression model, the conclusion is that there is significant impact of profitability, physical assets, size and growth on leverage ratio. In the given regression model there is no autocorrelation of the independent residuals (Durbin-Watson test is in its standard range - Durbin-Watson 2,200). (Note: Authors calculations with application of SPSS software).

The capital structure of the trade in Serbia is significantly affected, beside tested, also with other determinants.

5. CONCLUSIONS

Based on the given empirical research on the example of trade in Serbia we will give summary of the most important general and statistical results. In that context we specially point that the average values of all (and selected) capital structure determinants in trade of Serbia are lower compared to the same values of the trade in countries with developed market economies and "industry standards". It is due to unfavourable general business conditions.

The effect of some analysed determinants on financial leverage in trade of Serbia is different, what is quite logical - some affected positively, and some negatively. Negative effect on financial leverage had following determinants: current liquidity, assets growth and the assets structure, and the positive equity revenue. The other determinants had weak or moderate, positive or negative, influence on financial leverage. The significant influence on financial leverage, considering the correlation coefficients of assets growth and structure of assets has application of modern technology in trade of Serbia.

The received results of regression model clearly show that the specific selective determinants – current liquidity, return on revenue, firm growth and firm size do not affect significantly the capital structure of trade in Serbia (Sig. > 0,05). However, as a multiple regression coefficient and correlated determination coefficient show they altogether have significant effect on capital structure in trade of Serbia. In the given regression model, on the example of Serbia, there is no autocorrelation of independent residuals (Durbin-Watson test is in standard limits). The capital structure of trade in Serbia is significantly influenced, as a results of test show, beside tested, also with other determinants.

In trade of Serbia in the future, in the context of analysis and performance advancement in the broader sense, special attention should be paid to models of sustainable growth, as in tradition of developed market economies (Phillips, 2010). They belong to significant factors of cost reduction and, thus, profit increase. Therefore it should be used more in the trade of Serbia.

The significance of modern technology for advancing performance of retail chains is considerable (Shin, 2014). Its application in the retail chains in Serbia is still on unsatisfactory level compared to the countries of developed market economies, with an expectation that it will be improved in the future. It will have positive effects of financial leverage and its performance on trade chains in Serbia

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