

## **WHICH ARE THE CHALLENGES OF THE CORPORATE FINANCE WITHIN EAST EUROPEAN EMERGING COUNTRIES? OVERVIEW ON THE PECULIARITIES OF THE FINANCE MECHANISMS**

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***Abstract.** The European East emerging countries represent an interest research topic both in terms of macroeconomic environment and corporate finance decision. Their evolution within the process of nominal and real convergence process requires a challenging analysis of the way the main macroeconomic environment affects corporate segment. This analysis will focus in a first stage on the macroeconomic environment, highlighting out the way it evolved during the transition process from the centralized and planed economy to the market oriented one. Secondly, the focus will be oriented on the corporations based in these countries. Their finance decision will be analyzed in comparison with the corporations located into the emerging countries and moreover a deep interest will be granted to their leverage, especially from the point of view of the way finance mechanisms can be valorized based on their balance sheet data.*

**Keywords:** rating, sovereign risk, idiosyncratic risk.

### **1. Introduction**

There are 50 emerging markets worldwide. In order to get a deeper insight of the importance of these countries in the global economical architecture, a few statistics must be highlighted out: 1/5 of the global output is produced by them, 4/5 of the total population lives in these countries and 8,5% of the stock market capitalization at the global level belongs to these countries. The BRIC countries (Brazil, Russia, India and China) will be the largest economies by 2050 and in 2007 their cumulated GDP represents 48% of the global GDP.

The strongest points that are always pointed out as for the emerging countries imply strong currency, budget surpluses and a high rate of local consumption. The lack of correlation between their financial systems and the largest capital markets enabled specialists to conceive them as an important element in case of financial crises since investors have the opportunity to direct the capital inflows towards them in order to get a higher protection.

The negative aspects imply higher volatility, lack of transparency and liquidity. At the global level, there is a keen interest directed towards emerging countries because of the potential growth perspectives offered to the multinational

companies and to the low labor cost. Outsourcing became one of the most important strategies developed by all world-wide level corporations.

East European emerging countries imply a different research effort in terms of macroeconomic analysis because of the specific features determined by the transition process to the market-oriented economy.

Their strategic geographic position and their growth perspectives have been pointed out as two of the main advantages offered to the other developed European countries. Overall, their global market can be valued at more than 50 billion EUR which represents a huge opportunity for the companies of the developed countries in terms of products valorization.

Corporate segment is the most important growth resource for the East European emerging countries. It is appreciated as being the most important welfare mobile owing to the fact that it contributes in a fundamental way to keep up a decent living standard level.

Thus, it is important for the enterprises to have all the finance mechanisms opportunities in order to expand. But macroeconomic environment is a key factor in their case since it has been acknowledged that as for the emerging countries, the correlation between country and corporate rating is more substantial than in the case of the developed countries. The stability of the macroeconomic environment as well as the degree of economical growth, the inflation rate or the level of the capital market liquidity and transparency affect corporate segment.

This paper is related to the work of Haiss and Fink (2006) and of Berglof and Pajuste (2003) that highlighted the particularities of the corporate governance systems within Central and Eastern Europe. Similar research efforts on this topic have been made by Cavallo and Valenzuela (2007), and also by Huang and Kong (2003), Peter and Grandes (2005a), Borensztein (2006) who studied the relationship between corporate and sovereign spreads having as point of reference the corporate default premia limited to the case of publicly traded firms.

This study is more closed to the work of Borensztein (2006) who underlined the specific aspects of the corporate finance within emerging markets, but we propose to be more analytic in our research; first, there will be followed-up a global overview, based on the macroeconomic foundation while secondly we will concentrate on the micro-level approach, taking as point of reference the financial data corresponding to the enterprises located both into developed and East-European emerging countries.

This paper is structured as follows: the second section will contain an analysis of the macroeconomic environment of the East European emerging countries – Poland, Slovenia, Slovakia, Czech Republic, Slovakia, Romania and Bulgaria. The third section will concentrate on the corporate finance particularities and the fourth section is dedicated to the conclusions.

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### 2. From post-communism to European integration

Beginning with 1988, East-European emerging countries have gone through a deep restructuring process, from planned-centralized economy, characteristic to communism, to market-oriented economy.

This transition process has been a very challenging one, especially from the point of view of the privatization process. Since most of the enterprises were state-owned, the implementation of the structures specific to the liberalized economy, inclusively the private ownership, has implied many efforts both from the part of the public institutions but also from the part of the private entities. During a long period of time, the macroeconomic environment has been affected by real disequilibria which determined low living standard.

The macroeconomic volatility has been increased by higher political risk determined by an unstable political environment.

The EU adhesion represented an incentive for the authorities to struggle for a more competitive economical environment. Macroeconomic policies have been implemented in order to stabilize national economy and to integrate into the EU. In 2004, Poland, Slovakia Slovenia, Latvia, Estonia managed to integrate into EU while in 2007 Romania and Bulgaria became members too.

*Table 1*

#### **GDP weight of the EE emerging countries into the EU GDP weight**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bulgaria	27.9	29.4	31.1	32.6	33.6	35.2	37.1	38.7 <sup>(f)</sup>	40.1 <sup>(f)</sup>
Czech Republic	68.7	70.6	70.8	73.8	76.1	77	79.3	82.0 <sup>(f)</sup>	83.4 <sup>(f)</sup>
Hungary	56.3	59.1	61.7	63.6	63.9	64.8	65.3	65.4 <sup>(f)</sup>	65.3 <sup>(f)</sup>
Poland	48.5	47.8	48.5	49.1	50.8	51	52.9	55.2 <sup>(f)</sup>	56.7 <sup>(f)</sup>
Romania	26	27.6	29.4	31.5	33.6	34.4	37.6 <sup>(f)</sup>	39.1 <sup>(f)</sup>	40.4 <sup>(f)</sup>
Slovenia	78.9	79	81.3	82.5	85	86.6	88.8	91.7 <sup>(f)</sup>	92.9 <sup>(f)</sup>
Slovakia	50.3	52.5	54.3	55.7	57	60.4	63.6	67.6 <sup>(f)</sup>	70.2 <sup>(f)</sup>

\*f = forecasted value

**Source:** [www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

An analysis at the level of the GDP weight into the EU GDP reveals the fact that there are still lags which separate the EE emerging countries from UE. Overall, their average GDP represent 64% of the total UE GDP. Romania and Bulgaria continue to have the lowest GDP – only 40.4% and 40.1% out of the EU GDP - while Slovenia and Czech Republic have the highest values – 92.9% and 83.4%.

Table 2

GDP real growth rate within East European emerging countries, EU (27 countries) and USA

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bulgaria	5.4	4.1	4.5	5	6.6	6.2	6.1	6.3 <sup>(f)</sup>	6.0 <sup>(f)</sup>
Czech Republic	3.6	2.5	1.9	3.6	4.5	6.4	6.4	5.8 <sup>(f)</sup>	5.0 <sup>(f)</sup>
Hungary	5.2	4.1	4.4	4.2	4.8	4.1	3.9	2.0 <sup>(f)</sup>	2.6 <sup>(f)</sup>
Poland	4.3	1.2	1.4	3.9	5.3	3.6	6.1	6.5 <sup>(f)</sup>	5.6 <sup>(f)</sup>
Romania	2.1	5.7	5.1	5.2	8.5	4.1	7.7	6.0 <sup>(f)</sup>	5.9 <sup>(f)</sup>
Slovenia	4.1	3.1	3.7	2.8	4.4	4.1	5.7	6.0 <sup>(f)</sup>	4.6 <sup>(f)</sup>
Slovakia	1.4	3.4	4.8	4.8	5.2	6.6	8.5	8.7 <sup>(f)</sup>	7.0 <sup>(f)</sup>
EU (27 countries)	3.8	2	1.2	1.3	2.5	1.8	3	2.9 <sup>(f)</sup>	2.4 <sup>(f)</sup>
United States	3.7	0.8	1.6	2.5	3.6	3.1	2.9	2.1 <sup>(f)</sup>	1.7 <sup>(f)</sup>

Source: [www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

As for GDP real growth rate, it is obvious that East European emerging countries recorded high values in comparison with EU (27 countries) and also with USA.

Ever since 2000, the real growth rate for Bulgaria has been increasing continuously, from 5.4% to 6.1%. Romania had the highest growth rate in 2004 (8.5%) as well as Slovakia – 8.5% in 2006. Poland and Slovenia had a real growth rate of 5.2% and 4.1% in 2000 while in 2006 it increased to 6.1% and 5.7%. Hungary recorded the lowest real growth rate during this period; it decreased from 5.2% in 2000 to 3.9% in 2006 while in 2007 and 2008 it is expected that this value should get to 2.0% and 2.6%.

Overall, the analysts' expectations for 2008 in terms of real growth rate imply a slightly decrease for all the East European Emerging countries; nevertheless, the anticipated growth rate are superior to the growth rate expected both for USA and EU (27 countries) (1.7% and 2.4%) which validates the idea that East European emerging countries still have a higher growth potential than the developed ones and they continue to be attractive to foreign investors.

Inflation rate within East European emerging countries has decreased continuously from 2000 to 2006. The lowest values in 2006 were recorded by Czech Republic (2.1%), Slovenia (2.5%), Poland (1.3%) and Slovakia (4.3%).

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*Table 3*

**Inflation rate within East European emerging countries and EU (27 countries)**

	2000	2001	2002	2003	2004	2005	2006
European Union	1.9	2.2	2.1	2.0	2.0	2.2	2.2
Bulgaria	10.3	7.4	5.8	2.3	6.1	6	7.4
Czech Republic	3.9	4.5	1.4	-0.1	2.6	1.6	2.1
Hungary	10.0	9.1	5.2	4.7	6.8	3.5	4
Poland	10.1	5.3	1.9	0.7	3.6	2.2	1.3
Romania	45.7	34.5	22.5	15.3	11.9	9.1	6.6
Slovenia	8.9	8.6	7.5	5.7	3.7	2.5	2.5
Slovakia	12.2	7.2	3.5	8.4	7.5	2.8	4.3

**Source:** [www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

The highest inflation rates were recorded by Romania (6.6%) and Bulgaria (7.4%). In comparison with EU (27 countries) – 2.2% in 2006, the inflation rate of the East European emerging countries was higher which is in line with the assumption that their macroeconomic volatility is high. This assumption is enforced also by their current deficit.

*Table 4*

**Current deficit account within East European emerging countries**

	2000	2001	2002	2003	2004	2005
Bulgaria	-0.8	-1.1	-0.9	-1.5	-1.1	-2.5
Czech Republic	-3	-3.7	-4.4	-5	-5.3	-2.1
Hungary	-4.4	-3.6	-4.9	-5.9	-6.9	-6
Romania	-1.5	-2.5	-1.6	-2.9	-5.1	-6.9
Slovenia	-0.6	0	0.3	-0.2	-0.7	-0.5
Slovakia	-0.8	-2	-2.1	-0.2	-1.2	-3.2
Poland	-10.8	-6	-5.4	-4.1	-8.7	-4.1

**Source:** [www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

The highest current deficit was recorded in 2005 by Romania (6.9%) and Hungary (6%) while the lowest value is recorded by Slovenia (0.5%) and Czech Republic (2.1%). The current deficit is considered to be the most important danger to the macroeconomic stability; as long as efficient production structures will not be implemented in order to increase the level of exports, current deficit will threaten economic balance.

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During a period of at least 10 years after the beginning of the transition process, current deficit has not been considered an economic danger owing to the privatization process. The inflows directed by the foreign investors to the East-European emerging countries were high enough in order to support the deficit. Meanwhile, privatization resources have decreased and analysts appreciate that FDI will not be able anymore to cover it.

Romania country rating has been revised negatively by Standard&Poor's and Coface in 2007 because of the current deficit. Coface has downgraded the country rating which reflects the reimbursement capacity of the corporate sector from A to A-.

*Table 5*

**Foreign Direct Investments within East European emerging countries  
(mil. EUR)**

	2001	2002	2003	2004	2005	2006
Bulgaria			1499	2350	2744	3543 <sup>(p)</sup>
Czech Republic		8460	812	3227	8919	4198 <sup>(p)</sup>
Hungary	3159	2034	2577	:	5835	6246 <sup>(p)</sup>
Romania					5338	8874 <sup>(p)</sup>
Slovenia		595	321	499	454	269 <sup>(p)</sup>
Slovakia			619	641	1388	3171 <sup>(p)</sup>
Poland	5857	4236	3238	9441	6258	9168 <sup>(p)</sup>

\*p = provisional value.

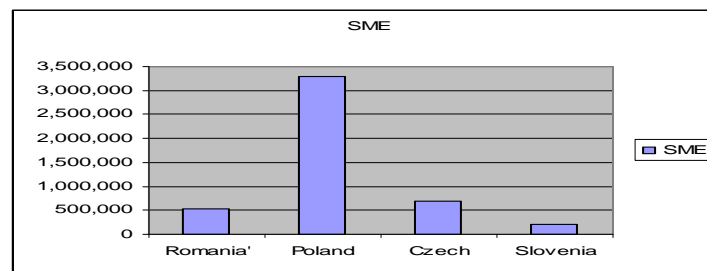
**Source:** *www.eurostat.ec.europa.eu*

FDI from Slovenia and Czech Republic have decreased in 2005 and 2006 from 454 /8.919 mil. EUR to 269/4.198 mil EUR. For the other countries, the dynamic was positive during the period 2001-2006.

The highest levels of FDI were attracted by Romania (record value in 2006 – 8.874 mil. EUR), Bulgaria (record value in 2006 – 3.543 mil. EUR) and Poland (record value in 2006 – 9.168 mil. EUR). Slovenia is for the moment the only country that managed to comply with the convergence criteria in order to adopt EUR. For the other countries, analysts appreciate that the EUR will be adopted later than 2012 (as for Poland and Slovakia specialists consider that EUR might be adopted in 2011-2012 while Romania may adopt EUR in 2015). The absorption rate of the European structural funds is an important indicator for the East European countries. The most competitive country is Slovenia who managed to have an absorption rate of 64%, Hungary 40% while Romania and Bulgaria have an absorption rate below 10%. In 2007, the group of the European East emerging countries benefited from 15,5 billion

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dollars. Analysts appreciate that the average absorption rate of the European Funds by the East European countries is 40%. In opposition with developed countries, corporate sector focuses mainly on SME which have a large weight within the GDP. In Romania SME represent 60% of the GDP and integrate 90% of the workforce while in SUA and Japan they represent no more than 40%-45% of the GDP. The highest number of the SME is located in Poland while the lowest one is located in Slovenia.



**Figure 1.** Number of SMEs per country

Corporate default rate in the EE emerging countries increased after the integration into the EU. Most of the corporate defaults were located in Hungary (19%) and Romania.

As for the corporate segment, the most vulnerable activities to macroeconomic volatility are textiles, trade, furniture industry, agriculture while IT, telecommunications and automobiles are the less exposed.

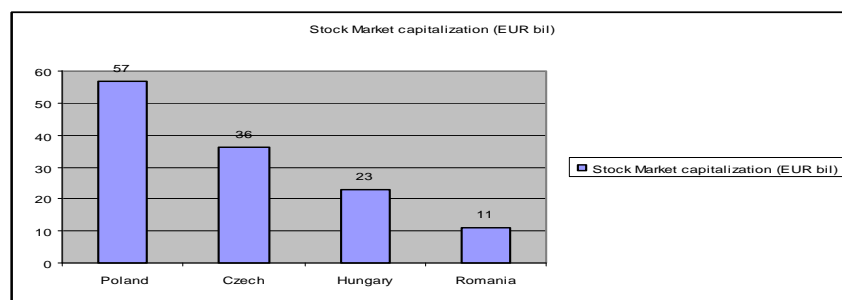
### **3. Financial instruments on the Eastern Europe stock market**

Corporate finance decision within East Emerging countries is highly influenced by the macroeconomic environment which exerts a deep impact on the finance mechanisms. The diversity and the solidity of the finance mechanisms are less developed and corporate entities face not only the challenge of the macroeconomic volatility, but also the difficult access to competitive finance resources which should permit them to valorize their growth potential. East European Stock Exchanges are perceived by investors as risky, illiquid and without transparency. Development level is generally lower than in the case of the developed countries. Communism regime determined a long inactivity period, 40 – 50 years, for stock exchanges. Low capitalization, absence of various investment instruments are usually the most common problems. Most of the stock exchanges have been founded within the privatization process in order to ensure a platform transaction for the shares. Stock exchanges from Czech, Poland and Hungary are the most important within Eastern Europe, both from the point of view of the capitalization process, but also from the point of view of the transactions value. The second group of Central and Eastern

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European stock exchanges from the point of view of the development degree is formed by Slovenia and Slovakia while the third group is formed by Romania and the other Baltic countries. In April 2005, the global market capitalization of the East European emerging stock markets was 123 billion EUR, which equals to 0.45% of the world stock capitalization, to 1.6% of the EU market capitalization and only to 7% of Euronext.

In terms of financial instruments, it is obvious that the degree of diversity is low; excepting stocks and bonds, there are few instruments that both investors and corporations could valorize.



**Figure 2.** Stock market capitalization within East European emerging countries

**Source:** *www.ktd.ro*

The most developed stock exchanges in terms of financial instruments are the Hungarian and Polish ones which possess also a securitization market valorized by the mortgage bonds. In Slovenia, Slovakia and Bulgaria, derivative products market is absent.

*Table 6*

**East European Stock exchange markets in terms of financial instruments**

Country	Instruments
Poland	stocks
	Bonds (corporate, government, mortgage)
	warrants
Czech Republic	stocks
	Bonds (corporate, government, mortgage)
Hungary	stocks
	Bonds (corporate, government, mortgage)
	bills



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Country	Instruments
Slovenia	stocks, bonds (corporate, government, mortgage)
Romania	stocks, bonds (corporate, government)
Slovakia	stocks, bonds (corporate, government, mortgage)
Bulgaria	stocks, bonds (government, corporate), depositary receipts

**Source:** *www.ktd.ro*

In terms of risk covering mechanisms, the most competitive stock exchanges are the Hungarian and Polish ones which possess derivatives on various instruments such as foreign currencies, indices, stocks. The most dynamic evolution in terms of corporate financing by the mechanism of the stock exchange belongs to Poland which performed 109 IPOs from 2004 to 2006. From 1999 to 2006, in Poland, Hungary and Slovenia, IPO's and secondary offers represent on average 5% of the total investments. Studies published on the Warsaw Stock Exchange site reveal the fact that listed Polish companies receive 25% of their financing from the stock market, 30% from self financing and other 30% from bank loans. In Hungary, 45% of the companies are credited by the intermediary of the banks, 35% by the stock exchange and 20% from self financing.

In Slovakia, corporate bank lending has recorded the most spectacular increase, from US\$ 16bn in 2004 to US\$29bn in 2009. Most of the companies (65%) have resorted to banking system in order to finance their activity while 25% have gotten to the stock market and 10% to the internal financing. Slovenian companies are also very receptive to bank financing. 70% of the corporations finance by bank loans, 25% by internal resources and only 5% by stock exchange. Romanian and Bulgarian companies finance themselves mainly by bank lending (65%) and internal resources (30%). Banking system within East European emerging markets is controlled more than two thirds by the foreign investors who bring capital and know how which contributes in an essential way to stability. Thus business environment becomes more competitive, foreign investors being considered also as a key corporate governance mechanism. Although corporations from East European countries are mostly bank-oriented in terms of finance mechanisms, the weight of the bank assets into GDP is still a low one (about 25%) in comparison with the countries from the euro zone (265%). Only Czech Republic and Slovakia have a weight of 130% and 95% into the GDP. In Hungary, financial intermediation is ensured by banking system to an extent of 75%. Poland has the highest number of banks (647) while Hungary and Slovenia possess the highest weight of banking assets into GDP (100% and 113.5%) while Romania and Poland have the lowest ratio (51.2% and 68.6%).

Slovenia and Hungary benefit from the most aggressive credit policy in terms of credit weight into GDP (64.5% and 58%) while Romania and Poland have the lowest ratios (28% and 34.3%). Saving rate valorized by the weight of deposits into GDP is the highest for Slovenia and Czech (57.7% and 63.9%) while the lowest is recorded by Romania (29.7%) and Poland (41.1%).

Table 7

**Banking system within East European emerging countries**

	NB	Bra/1 mil. inhabitants	F b	Ba/GDP	Tc/GDP	Td/GDP
Poland	647	321	70%	68.6%	34.3%	41.1%
Hungary	41	137	95%	100%	58%	45.6%
Czech	37	183	96%	97.3%	42%	63.9%
Slovakia	24	218	98%	87.6%	40.8%	56.8%
Slovenia	22	345	35%	113.5%	64.5%	57.7%
Bulgaria	29	319	81%	86%	46.2%	55.5%
Romania	38	204	89%	51.2%	28%	29.7%

\* NB – no. of banks

\*Bra/1 mil. inhabitants – Branches per 1 million inhabitants

\*Fb – no of foreign banks

\* Ba/GDP – Bank assets reported to GDP

\* Tc/GDP – Total credits reported to GDP

\*Td/GDP – Total deposits reported to GDP

Overall, finance mechanisms for East European emerging countries corporate segment are based mainly on bank loans and internal resources. Stock exchanges are not developed at the level of ensuring solid finance mechanisms, but for the 6 years to come their development has been already forecasted. Corporate finance decision will be in this case highly impacted by a switch from a rigid banking system finance mechanism to a more flexible one, represented by the capital market.

**4. Corporate finance decision in the Eastern Europe**

The case study focuses on the corporate finance decision within East emerging countries. There will be tested 3 relationships between capital structure and various financial indicators reflecting liquidity, profitability and activity of the enterprise in order to highlight out potential specific features of the finance mechanisms characteristic to companies located into East European emerging countries.

*4.1. Database and methodology description*

The sources the information was obtained from were the following:

- Hewlett-Packard Credit Division containing information relative to the Financial Statements of various companies located both in emerging East European countries (Poland, Slovenia, Slovakia, Bulgaria, Czech, Romania);

- Economic Intelligence Unit site regarding the macroeconomic environment of the emerging East European countries.

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The assembly of financial indicators that will be analyzed is the following: Current Liquidity ratio ( $I_1$ ), Quick Liquidity ratio ( $I_2$ ), Short Term Debt Cash-Flow Coverage ( $I_3$ ), Return on Tangible Net Worth ( $I_4$ ), Earnings before Taxes/Total Assets ( $I_5$ ), Operating Expenses/Net sales ( $I_6$ ), Debt/Tangible Net Worth ( $I_7$ ), Interest Coverage ( $I_8$ ), Short Term Debt/Total Debt ( $I_9$ ), Leverage multiplier ( $I_{10}$ ), AR turnover ( $I_{11}$ ), AP turnover ( $I_{12}$ ), Working Capital Turnover ( $I_{13}$ ), Total Assets Turnover ( $I_{14}$ ), Altman Z-score ( $I_{15}$ ).

The methodology that will be followed up is based on the analysis of the output regression built up by the OLS procedure.

The dependent variable will be represented by 2 financial indicators reflecting the capital structure of the company: leverage multiplier and the weight of the short term debt into the total debt. Leverage multiplier represented by the report between total assets and equity has been selected in order to get an insight into the self-financing policy of the enterprise. This variable is significant for the East European emerging countries because it reflects the internal finance resources. Indeed, in the context of capital market and banking system underdevelopment degree, internal finance resources are valorized to a high extent; moreover, since companies located into these countries are perceived as riskier, their internal finance resources are very important in order to get additional external resources.

The level of assets usually perceived as an indicator reflecting the size and the activity dynamic has been perceived lately by the finance resources providers as a covenant for the company and its importance becomes much higher in the case of the companies located into East European countries.

The independent variables which are considered to exert an influence on the capital structure and on the finance decision are Earnings before Taxes/Total Assets ( $I_5$ ), Operating Expenses/Net sales ( $I_6$ ), Debt/Tangible Net Worth ( $I_7$ ), Working Capital Turnover ( $I_{13}$ ), Total Assets Turnover ( $I_{14}$ ), Return on Tangible Net Worth ( $I_4$ ).

The output statistic will be analyzed in order to highlight out the impact of every indicator on the capital structure.

#### *4.2. Descriptive statistics analysis of the financial indicators*

It is obvious that most of the companies located in emerging countries had adopted financing structures based on long term debt since a higher weight of the short term debt into the total debt will make them being perceived as riskier. The financial effort implied by the long term debt is considered to be softer than the one implied by the short term debt.

The standard deviations corresponding to the financial indicators of the companies located in emerging countries are high.

Table 8

**Descriptive statistics of the corporate rating for companies located in emerging countries**

		Confidence interval	Confidence interval		
	Mean	-95.000%	95.000	Minimum	Maximum
VAR1	1.232353	1.150821	1.313884916	0.71	2.25
VAR2	0.832353	0.749112	0.915593998	0.11	1.95
VAR3	1.914706	-2.01051	5.839917453	-1.01	99.62
VAR4	35.2919	26.8066	43.77720084	-13.22	131.92
VAR5	40.17451	-2.22191	82.57093339	-4.65	822
VAR6	8.782941	5.643163	11.92271901	-1.05	49.6
VAR7	4.820922	2.455366	7.186477441	-7.24	45.58
VAR8	3.35098	1.450728	5.251233033	-5.44	41.61
VAR9	94.15098	91.11233	97.18963215	49.2	100
VAR10	5.586039	3.458177	7.713901303	-6.24	43.21
NEWVAR11	25.52392	-9.66817	60.71601801	2.02	900.66
NEWVAR12	14.4851	2.833387	26.1368088	1.43	293.3
NEWVAR13	25.70922	-5.84364	57.26206901	-634.8	361.5
NEWVAR14	12.64373	-5.84446	31.13191102	1.2	472.82
NEWVAR15	13.96863	-5.43839	33.37564754	1.94	497

The instability conferred by the macroeconomic environment is dominant in the case of the emerging countries.

The variance corresponding to the leverage multiplier is 57.23; the Altman Z-score has also a high variance -3.341, 502.

From this perspective, we can assume that macroeconomic environment had a strong impact on the corporate rating. The macroeconomic volatility implied by the emerging countries environment affects the evolution of the financial variables.

*4.3. Statistical perspective on the corporate finance decision within East emerging countries*

In order to get a deeper insight regarding the particularities implied by the finance decision within East emerging countries, there have been performed three regression test. The regressions conceived the corporate rating as dependent variable and all the other variables as independent ones, including the country rating.

The first statistical test focuses on the relation between the leverage multiplier and indicators reflecting the profitability ( $I_5$ ) and the size ( $I_6$  and  $I_7$ ) of the enterprise.

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This relation can be modeled as:

$$L = -0,03726 \times P + 0,585511 \times NS - 0,10551 \times T$$

Where:

- L – leverage multiplier;
- P – EBT/TA;
- NS – Operating expenses/Net Sales;
- T – Debt/Tangible Net Worth.

Analyzing the output of the first regression, it is obvious that there is not a deep correlation between the leverage multiplier as an indicator of the capital structure and the liquidity and dynamic activity indicators for the companies based in the emerging countries.

Nevertheless, the Earnings Before Taxes reported to total Assets and the Total Debt reported to Tangible Net Worth are correlated negatively with the leverage multiplier. The second negative correlation is in line with the assumption that as for companies located into East European countries, their finance decision is based mainly on internal financing and they are reluctant to indebtedness. As far as they focus on self financing, equity level is high.

*Table 9*

**Output of the capital structure regression**

R= ,52996761 R <sub>c</sub> = ,28086567 Adjusted R <sub>c</sub> = ,01119030						
F(3,8)=1,0415 p<,42516 Std. Error of estimate: 1,3260						
		St. Err.		St. Err.		
	BETA	of BETA	B	of B	t(8)	p-level
Intercept			-6,56923	6,23822	-1,05306	0,323077
VAR5	-0,03726	0,313018	-0,21126	1,774713	-0,11904	0,908179
VAR6	0,585511	0,366229	1,299479	0,812807	1,598756	0,148542
VAR7	-0,10551	0,356449	-0,06206	0,209657	-0,29599	0,774773

The second correlation strengthens the idea that finance decision of the companies located into East European countries does not imply automatically the reinvestment of the profit although internal resources is dominant as finance mechanism.

This assumption reflects the fact that self financing implies mainly contributions brought by stockholders while the profit is distributed as dividends and not reinvested.

The positive correlation is established between the dimension of the company and the level of equity. As far as the company manages to have a high level of sales, its equity will increase.

The second regression conceives the weight of the short term debt into total debt as dependent variable (I<sub>9</sub>) and as independent variables there have been used the same as in the case of the first regression.

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The correlations are the same as in the case of the first regression. The weight of the short term debt into the total debt is correlated negatively with profitability and the weight of the fixed assets and positively with the size of the company.

The relation can be modeled as follows:

$$S = -0,25637 \times P + 0,248579 \times NS - 0,03599 \times T$$

Where:

S = short term debt reported to total debt;

P= EBT/TA;

NS= Operating expenses/Net Sales;

T= Debt/Tangible Net Worth.

Table 10

### Output of the capital structure regression

		St. Err.		St. Err.		
	BETA	of BETA	B	of B	t(8)	p-level
R= ,29933243 R <sub>c</sub> = ,08959990 Adjusted R <sub>c</sub> = -----						
F(3,8)= ,26245 p<,85060 Std. Error of estimate: 1,8980						
Intercept			93,91898	8,929264	10,51811	5,81E-06
VAR5	-0,25637	0,352192	-1,84917	2,54029	-0,72794	0,487409
VAR6	0,248579	0,412064	0,701848	1,163435	0,603254	0,563048
VAR7	-0,03599	0,401059	-0,02693	0,300099	-0,08974	0,930703

The output statistic reflects the fact that their financing policy does not imply a differentiation between the short term and the long term approach. The financial indicators are correlated in the same way both with equity level and short term debt.

For the period to come, it is obvious that this differentiation will be implemented under the context of stock exchange development.

The third regression conceives the short term debt reported to total debt as dependent variable and as independent variables working capital ( $I_{13}$ ), accounts receivables turnover ( $I_{11}$ ), current liquidity ratio ( $I_1$ ) and return on tangible net worth ( $I_4$ ).

The relation can be modeled as follows:

$$S = -0,06308 * Lq + 0,000467 * RT + 0,086124 * AR + 0,309613 * WC$$

Where:

S = short term debt reported to total debt;

Lq = current liquidity ratio;

RT = return on tangible net worth;

AR = accounts receivable turnover;

WC = working capital turnover.

**Which are the challenges of the corporate finance within East European emerging countries?**

*Table 11*

**Output of the capital structure regression**

		St. Err.		St. Err.		
	BETA	of BETA	B	of B	t(7)	p-level
R= ,31905440 R <sub>e</sub> = ,10179571 Adjusted R <sub>e</sub> = -----						
F(4,7)=,19833 p<,93146 Std. Error of estimate: 2,0154						
Intercept			97,34638305	2,620085	37,1539	2,66E-09
VAR1	-0,06308	0,373947	-0,598695	3,548986	-0,16869	0,870808
VAR4	0,000467	0,380508	0,000350906	0,28597	0,001227	0,999055
NEWVAR11	0,086124	0,385685	0,038984824	0,174583	0,223302	0,829677
NEWVAR13	0,309613	0,363823	0,074424036	0,087455	0,851001	0,422921

Output statistic highlights out a negative correlation between liquidity ratio and the weight of short term debt into total debt which is in line with the assumption that a high level of indebtedness determines outflows of liquidities.

The positive correlations are established between the accounts receivable turnover, working capital turnover, the return on tangible net worth and the indebtedness indicator which reflects the fact that an increase of the activity of the company will be supported by a more aggressive financing policy based on external resources.

**Conclusions**

The article focuses on the particularities of the finance corporate decision within East emerging countries. The statistic output highlights out the short term approach of the financing policy. There has been no differentiation between the correlations established at the level of various financial indicators and the short term debt/long term debt.

For the years to come, in the context of the capital market development, there will be a switch from the short term approach of the financing decision to the long term one.

The intensity of the negative correlation between liquidity indicator and indebtedness degree will decrease since the financing policy will be conceived having as reference the long term approach which will reflect higher projection degree.

Their financing policy focuses mainly on internal resources valorized by the practical contributions brought by shareholders within the company while profit is mainly distributed as dividends and not reinvested.

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