The Capital's Election Criteria Used in the Financial Management of a Company's Financing Decision

Camelia OPREAN
Constantin OPREAN
University Lucian Blaga of Sibiu, Romania
E-mail: rector@ulbsibiu.ro

Abstract

The optimization of the capital structures of a company after the cost criteria represents a profitable activity, provided that it is well conceived, organized and carried out. For this consideration, the capital's structure and their medium cost is an important profit source for the company, so the profit comes from this source, and not from the exploitation activity or other financial sources or traditional exceptive. In conclusion, the cost of the capital has to be previewed; the company has to build an adequate strategy and tactical procedures to accomplish this challenge.

Besides the capital's cost, in this paper we present some other criteria that can interfere in the choice of the financing method, all depending on the financial situation of each company and on its strategy.

Keywords: *cost, financial structure, shareholders' equity, debt*

JEL classification: P34, E44

Provided that the weak capitalization of Romanian companies is one of the main causes of the incompetent use of their assets, the assurance with financing sources at accessible costs gains an essential importance for the concerned economic agents.

The dynamics of the business system require that funds be available at any time from a variety of sources, provided internally or externally. The main internal sources are cash flows from profitable operations and the main external sources are borrowing or raising new equity. Because the basic purpose of investing in, operating and financing a business is to increase the economic value of the owners' stake over time, management decisions should create economic value for the shareholders by generating after-tax results that are higher than the cost of all the supporting capital inputs (Helfert, 2003).

A traditional view upon the cost of capital – the main criteria in financing decision

In the process of establishing the decisions of resorting to the outer capital flow, including owner's contribution, the cost as financial indicator is more and more important as an essential restriction. The cost is the highest risk element that accompanies the capital, as it is in inverted ratio with the profit: a high cost leads to low gain, results, in the present case, only from the bad financial management (Bogdan, 2002).

Thus, it is important to determine the measure of these costs, at least from the following views: for the improvement of the activity, costs have to be the lowest possible; to choose the adequate structure of the company, meaning of the optimum ratio of its own capital - borrowed capital.

The cost of the capital represents the profitability ratio demanded by the capital providers, either shareholders or creditors, in other words, the cost of the capital is the financial effort that has to be made by the company in order to provision itself with capital. Ultimately, the cost of the capital is the minimum yield obtained by the investors, in measure to guarantee the shareholders a profit which can be compared with the one they could obtain on the market in the same risk class.

There are costs connected with obtaining financing and compensating providers of various sources of funds, both short term and long term, which must be considered by management in making any financing decision. Clearly, using any type of funds entails an economic cost to the company in one form or another. One of the management's obligations is to develop a pattern of funding that both matches the risk-reward profile of the business and is sufficiently adapted to meeting the evolving needs of the company.

The cost of capital comes mainly from:

- the dividends due to the capital holders, for their contribution at the gathering of the company's funds;
- the interest due for the mandatory bank loans, and other refundable loans.

In all cases, the cost of a financing source, either own capital, or borrowed capital, cannot be accepted if it is lower or equal to the yield ratio demanded by the enterprising party.

Despite of frequent references to the capital cost, theoreticians encounter difficulties in their use and in calculation. However, the capital cost has to be calculated, to determine that financial structure that allows the cost lowering. Therefore, the weighted average cost of capital measure, which we'll discuss shortly, is the most significant criterion of cost in the capital budgeting and investment analyses context. To complete the already discussed aspects, we will further refer to the cost of different capital categories as follows:

- the cost of shareholders' equity;
- the cost of the medium term and long term borrowed capital;
- the cost of leasing.

The cost of shareholders' equity can be looked upon from two perspectives: like an explicit cost, and like an implicit cost (Toma, Alexandru, 2003).

The explicit cost determines an exit money flow. All capital infusions from outside the company determine explicit costs as the remuneration demanded by the investitures to lodge their money represent an explicit cost for the company (the borrowing interest and the share dividend).

The implicit cost, or the opportunity cost does not imply financial exit flows (payment). It refers to financing sources which are formed inside the company and which are used directly (the amortization fund, the unassigned benefit, the extra fund etc.). Even if this type of resources appears as "free", they practically have a cost because they belong to the shareholders and if these sources are transmitted to them, the shareholders can capitalize them.

The general rule imposed by the modern financial theory says that the own fund remuneration has to be equal to the risk-free interest ratio, plus a risk bonus. The risk-free ratio is the minim interest which the shareholders could receive, if they would invest their capital in risk-free placements (for example, state bonds), instead of presenting them to different investors, which supposes a certain risk, so an unclear profitability. The risk bonus represents an increase of the profitability demanded by the shareholders which will compensate the risk they assume when they decide to place their liquidness in shares.

The cost of the personal capital takes into consideration the shares yield and the presumable growth of the dividends, more precisely it is equal to the actuarial ratio, which is obtained from the equality between the stock market value of the company and the actuarial value of the future positive fluxes (the actuarial value of the remuneration of shareholders plus the final value of the shares when they are sold).

An evaluation model of the personal capital is the Gordon – Shapiro (1956) model, to determine the share cost, further developed by Gordon (1962). This is a simplified variant of the updated value model, according to which a share's value is equal to the actualized value of the future liquidities generated as dividends and the sell price (course). The rentability (the explicit cost) of a share for the investor is the update ratio which allows the equality between the value of this share and the future equities flows.

As an evaluation of all future equities payment is very difficult to provide, the model has introduced a constant growth ratio of the dividends for the following years, materialized in the following formula:

$$V_0 = \sum_{i=1}^{\infty} \frac{D_0(1+g)^{i-1}}{(1+r)^i},$$

where:

V_0 = the present value of a commune share;
D_0 = the dividend obtained in the first year;
g = the constant growth ratio of the dividends;
i = the number of years;

r = the actualizing ratio of the dividends or the profitability ratio demanded by the investors.

The real cost of the company's capital can be calculated as a sum between the expected dividend yield and the expected dividend growth:

$$\text{Kpr} = \frac{D_1}{P} + g,$$

where:

Kpr = the personal capital cost;

D_1 = the dividends that have to be paid in the following year;

P = the price on market of a share;

g = the constant growth ratio of dividends (or the income growth ratio).

Introducing estimated growth in dividends into the formula is an improvement that implicitly recognizes the effect of reinvestment of retained earnings on the value received by shareholders. The assumption here is that over time, successful reinvestment of retained earnings will lead to growing earnings and thus growing dividends. The difficulty, however, lies in determining the specific dividend growth rate, which must be based on our best assumptions about future performance, tempered by past experience.

In the case of countries with developed financial markets, the determining of the capital cost in case of the marketable share-held societies is eased by the existing famous financial companies (rating and evaluation societies) which offer very rigorous evaluations of the future dividends, of their growth ratio an of the risk bonus. This method of dividend evaluation can be used to estimate the personal capital costs in any growth hypothesis of the dividend.

But in the case of our country, applying the Gordon-Shapiro model has minor relevance (Sandu, 2000). The approach suffers from serious oversimplification, because companies vary greatly in their rate of dividend payout, and the method does not specifically address the effect of reinvestment of retained earnings. On the other way, the distributed dividend is too little as to be taken into consideration, and on the other way, an estimation of the growth ratio of the dividends is impossible, mainly due to the instability of the economic life. In addition, the models of valuation of personal funds can only provide a good result if the shares are correctly estimated.

The required return on common stock can also be calculated by an alternate approach called the capital asset pricing model (CAPM). Some accept the CAPM as an important approach to common stock valuation, while others suggest it is not a valid description of how the real world operates. CAPM method defines the cost of common equity as the combination of the risk-free return and a risk premium that has been adjusted for the specific company risk. Under the capital asset pricing model, the required return for common stock (or other investments) can be described by the following formula:

$$Ke = Rf + \beta(Rm - Rf),$$

where:

Ke = the cost of equity capital
Rf = the risk-free return (interest rate on government bond)
B = the company's covariance of returns against the portfolio
Rm = the average return on common stocks.

The cost of the loan, under its diverse forms, can also be defined as the actuarial ratio which is determined by the equalization of the sums received with loan title on one way, with recurrent refunds and the financial outgoings on the other way.

The explicit cost of a loan is that cost which equalizes the incoming payments from the borrowed funds (returns) with the actual payment value (refunds - rates and future interests), according to the formula:

$$Borrowed \cdot funds = \sum_{t=1}^{n} \frac{(Rates + Interests)_t}{(1+i)^t}$$

in which t = 1,...,n years of refund of the loan.

Fisher states that not the nominal ratio, but the real interest ratio is that on which the offer and demand depend on the capital markets (Hoanta, 2002). Thus, considering the inflationary context, the interest is presented under the form of real interest:

The nominal ratio of the interest = The real ratio of the interest + The ratio of the attended inflation

In an economy with high inflation ratio, as the Romanian economy continues to be, this equation is fairly imprecise for the exact calculation of the real interest ratio.

In what the real interests concerns, these are of two types:

- the real positive interests are those interests that cover the normal cost and the inflation, remaining an extra in favor of the capital holders;
- the real negative interests are the real interests that do not cover the inflation ratio, and thus the capital holders loose the substance of the capital.

The cost of financing by bonds has to be regarded as the interest determined over an interest ratio which the company has to pay to grow its capital needs.

The problem that appears here is to determine the actuarial ratio (the actuarial cost) of a such a loan. This ratio represents the effective ratio which is paid by the borrower and received by the creditor, determined not only by the nominal interest ratio, but also by other agents: the discount emission, the bonus emission, and the refund price.

In a society, positive flows (returns), and negative flows (outgoings, costs) take part by issuing of promissory notes. For a net treasury incoming (the emission price), there are correspondent net treasury outgoings under the form of the

following financial flows: the annual payment of coupons for *n* years, and the sop, in the year *n*.

The net cost of the bonds financing is obtained by the actuarial calculus after the following general formula:

$$V_0 = \sum_{t=1}^{n} \frac{F_t}{(1+i)^t},$$

where:

V_0 = the actuarial value at time "0";

F_t = the money flows created by the company;

i = the interest ratio at a monetary unity.

Another procedure to calculate the net cost of the bonds financing loan starts from the following formula:

$$\text{Net cost} = \frac{F + \frac{PR - PE}{n}}{\frac{PR + PE}{2}},$$

where:

PR = amount payable upon redemption;

PE = the emission price.

In the Romanian economy, the main problem in calculating the cost of a longer than a year debt is the closest to reality anticipation of the interest. As we have seen, the nominal interest is mainly determined by the inflation ratio. So, provided the high instability of the Romanian economy, in case of a bonds financing on a longer than 5 years term, the estimation of a nominal interest is uncertain.

As the **bank credits** do not imply extra costs, as in the case of bonds financing, the actuarial cost of the bank credits is very close to the nominal interest ratio, and sometimes it is identified with it.

The sum of the interest for the bank credit depends on three items: the credit volume, the interest rate and the crediting time[1].

$$D = \frac{C \cdot t \cdot i}{100},$$

where:

D = the capital cost (the interest);

C = the credit (the borrowed capital);

t = the time for which it was given;

i = the annual interest ratio.

[1] This is the calculus formula for the borrowed capital cost for more years. In the case of the capital borrowed on short term, in the capital cost calculation formula the term P" ($D = \frac{C \cdot t \cdot i}{P \cdot 100}$), is introduced, which equals 12 months, when the credit was given for more months, or with 360 days, when the credit was given for more days.

The cost of the bank credit is calculated according to the following formula, where the term "m" represents the number of the composition period in one year:

$$K = \left(1 + \frac{Interest}{Credit}\right)^{m} - 1$$

Speaking about **the cost of leasing**, the investing and financing decisions are separate for the leasing society and for the using society; in conclusion the operation cost has to be separately calculated.

The capital cost for the leasing society is a medium ponderate cost of the total capital (the personal capital and the borrowed capital), influenced by the tax incidence like in any other society (Teodor, 1999):

$$K = \left[Q_p \frac{C_{pr}}{C_{pr} + D} + Q_d \frac{D}{C_{pr} + D} \right](1 - I)$$

and

$$Q_p = \left[r_e + \frac{Dat}{C_{pr}}(r_e - Q_d) \right] \cdot (1 - I)$$

where:

K = the medium ponderate cost of the capital for the leasing society;
Q_p = the cost of the personal cost for the leasing society;
Q_p = the cost of the duty for the leasing society;
I = the assessment quota on profit;
C_{pr} = the personal capital;
D = the borrowed capital;
r_e = the economic profitability;
r_f = the financial profitability = Q_p.

If the leasing companies execute in the same time credit operations, they aim at preserving the same risk, so as their investment will have an economic profitability at least equal with the capital cost, to which the ax incidence is added. As a result of the equal economic risk, assumed between the crediting and leasing operations, the cost of the loan for the leasing society is identical with the minimum cost of the user's leasing.

$$K = k(1 - I) \qquad \text{or} \qquad k = \frac{K}{1 - I}$$

where:

K = the medium ponderate cost of the capital for the leasing company;
k = the capital cost for the user (the minimum cost of the debt).

To analyze if this activity is profitable for the leasing societies, we turn to the actualized net value calculus, as for any investment (Teodor, 1999):

$$VAN = -C + \sum_{t=1}^{n} \frac{Lt \cdot (1 - I) + A_t \cdot I}{(1 + K)^t} + V_r$$

where:

n = the number of years to amortize;
C = the value of the given leasing credit;
V_r = the residuary value;
L_t = the annual liquidities flow;
A_t * I = the tax economy, as a result of the amortization from the taxable basis (a positive flow for the leasing society).

Because most companies use more than one form of capital in funding investments and operations, and because the mix of sources used for long-term financing can change over time, it's necessary to examine the cost of the company's capital structure as a whole. The result we're looking for is a cost of capital figure that is weighted to reflect the mix of the various capital sources used as a matter of policy.

The weighted average cost of the capital (WACC) is a ponderate arithmetic mean between the capital categories ponders and the costs of these different financing sources. In the most simple form, the company's capital is composed of only two title categories: the ordinary debts and stocks. In this situation, the medium ponderate cost of the capital is determined by the following:

$$WACC = k_c * \frac{C}{C + D} + k_d (1 - T) * \frac{D}{C + D}$$

where:

k_c = the personal capital cost;
k_d = the cost of the debt forwarded by taxing;
C = the stock value of the personal capital;
D = the value on the market of the debts;
T = the taxing ratio[1].

The current capital structure as reflected on the balance sheet is the result of past management decisions on funding both investments and operations. The question to be asked here is whether the types and proportions of capital in this structure are likely to hold in the future, that is, whether they match the strategic plans of management. One common way of dealing with the issue of weights is to identify a "target" level of debt versus equity, which management identifies as a longer-term objective, even though near-term fluctuation might occur (Helfert, 2003). This is done to relate the cost of capital to the strategic direction of the

[1] The economic incidence of taxation is included in the cost calculus, as a result of the spendings deduction with the interests from the taxing profit.

company, and also to avoid introducing fluctuations in the cost of capital measure which, after all, is to serve as a long-term gauge for value creation.

From the investors' point of view (shareholders or creditors), the WACC represents the minimum level of the total profitability which a company has to obtain by using its activities to maintain the invested capital. The WACC calculus shows its utility in selecting the investment projects, which are considered the minimal step, under which the investors will not accept to be placed, the profitability required for any company investment which has an identical risk with that of the company as a whole.

The basic logics to calculate the weighted average cost of the capital is that when the capital cost for a certain project is estimated, the company has to approach the issue in its complexity. Thus, no capital component has to be considered strictly as a separate entity, because an important investment part will sooner be financed from a component package of the capital, than just one financing source. If the company only uses debts for financing its investment projects, its capacity to acquire debts in the future will drop. A perpetuation of the financing by one financing source can lead to under optimal investment decisions which decrease the company's value. For this reason the company has to use a capital cost that reflects all fund types which the company will use to finance its transactions.

The financial managers use **the marginal capital cost** method because this represents the additional cost to obtain a new capital monetary unit. This grows as the capital grows. In other words, the company cannot acquire, at the medium calculated cost, more than a limited capital quantity. The exceeded value will have to undertake a certain growing marginal cost.

The financing level which a company with unassigned profit can afford, combined with the debt capacity and the preferential stocks, before being forced to issue commune stocks, is given by the critical point, which refers to the new capital value which can be increased before a growth of the medium ponderate cost of the capital existent in the company:

The critical debt point = The sum of the debt at the lower cost / Debts as a percentage from the total capital

This formula can be presented in a more general manner, and it can be applied for any capital component:

The critical point for a capital component = Total sum of the capital component at the lower cost /
The percentage of that component from the total capital

The critical points may appear if the interest rates grow, if the costs of the preferential stocks grow or if the cost of issuing the common stocks grows.

The rentability criteria in choosing the financial structure of a company

As we have seen, the choice of a financing manner is determined on one way by its cost and on the other by its existing financial structure. An appropriate financial structure corresponds to a minimum capital cost. It has been pointed out in many cases that the functioning of a company with no adequate budget is one of the most frequent causes of business failure. Added to the adequate capital (in terms of volume), the company has to have an adequate capital structure: the correct (optimum) combination of personal capital and loans.

By the capital structure of a company we understand the relative proportion of the personal capital and of the debt used to finance its assets. In other words, the financial structure of a company reflects its capital structure.

Determining the financial structure of a company signifies finding the answer to two basic questions (Hoanta, 1996):

1. How do the total fund sources have to be divided between the long term and short term financing?

2. What is the proportion between the debt financing and the personal capital financing (stocks)?

The answer to the first question requires heading our attention to the nature of the actives owned by the company. The immobilized assets, that represent permanent needs (personal capital and on term debts), is advisably to be covered (financed) by the permanent capital (the personal capital and on long term debts), while the temporary assets, mainly formed from stocks and other material values, from claims on customers and different immediate liquidities, can be covered, by possibilities, by the work capital (which is a permanent capital), but also by short term debts formed from bank credits and bonds to the suppliers. In conclusion, the company's financial structure (the capital) can be rendered not only as a ratio between debts and personal capital, but also as a ratio between the short term and long term financing.

The financial structure decision will have to be the appropriate one, that is a ratio will have to be established between the credit and private resources financing so as the financing costs will be as low as possible. This depends on the objectives for the economic growth of the society, on the attended profitability level and on the risks which it agrees to assume, but also on third parties, shareholders, banks and other loaners, on the state and on the economic conjuncture.

The capital structure decision was first tackled in a rigorous theoretical analyses by the financial economists Modigliani and Miller in 1958. MM created a simplified model and concluded that the value of a firm remains constant regardless of the debt level. By the debt effect we understand the positive or negative financial effect which the economic agent obtains as a result of the use of credit as capital. It is obtained by comparing the economic rentability of the company (Re) with the cost of the borrowed capital (d= the interest ratio). If we take into consideration the general formula of the debt effect (Sandu, 2000), presented as follows, we observe that this rentability is connected with the existent

proportion between the financial debts (D) and the personal capitals (K), R_e being the economic rentability[1], d the medium cost of the financial debt and I the taxation ratio:

$$R_f = (1 - I)\left[R_e + \frac{D}{K}(R_e - d)\right]$$

We can draw some conclusions from this relation:

✓ The financial rentability is direct proportional with the financial structure Debt/Own Capital and with the difference between the economic rentability ratio (R_e) and the interest ratio(d). Practically, the financial rentability is larger as the financial structure is in debt and as the difference between the economic rentability ratio and the interest ratio is larger.

✓ For an enterprise with no debts (D = 0), the financial rentability ratio coincides with the economic rentability ratio ($R_f = R_e$). The same situation is registered if $R_e = d$, when requiring a credit will have no effects upon the financial rentability, the level being equal with that of the economic rentability;

✓ If $R_e > d$, R_f is higher if D/K is higher, requiring to borrowed capital will result in the growth of the financial rentability ($R_f > R_e$). The leverage effect (of financial lever) has a positive role. Thus, the company that wants to maximize its financial rentability will have to choose to borrow, not to grow its own funds, in the case of imposed financial restraints;

✓ If $R_e > d$, R_f is lower if D/K is higher, meaning that the contracting of new loans will take to the reduction of the financial rentability ratio $R_f < R_e$). The debt effect has a negative role. In this case, the company will have to stop taking new loans, because the debt harms the company's performances.

In addition to that, any variation of the economic rentability has serious repercussions on the financial rentability, in positive or negative directions, and these are more prominent if the debt is high. In the case of the positive lever effect, by taking debts, the company increases its financial rentability, making it more fragile at the same time, more risky, more sensitive to the economic rentability turbulences. The majority of the risk corresponds to a rentability extra.

But for this judgment to be liable a certain period of time, it has to be based on a certain stability of the elements considered (economic rentability, medium debt cost, etc)

Other criteria with impact upon choosing a company's financing methods

In the case of companies, numerous other criteria can interfere in the choice of the financing method (Hoanta, 1996), all depending o the financial situation of each company and on its strategy. Some of these criteria are given as follows:

Taking into consideration the size of the company

[1] The economic rentability ratio is obtained as a ratio between the net result of the exercise and the value of the total actives, and shows the efficiency of their transaction in the analysed period.

"The theory of the access cost of financing", starting with this criteria, it refers to the following:

- small companies finance their investment by cash-flow issued by its own activity or by associate's contribution, using next the negotiation ability to obtain an important credit from the suppliers, and they finally address to banks.
- the medium companies have difficulties in drafting titles. However, they have a higher negotiation power (than the precedent) with banks, and they can demand a higher debt.
- large companies make little use of the bank debt, or the supplier credit, but they are addressed especially to the financial markets.

Evidently, large companies have a broader choice area than the small ones. For instance, the latter cannot recur to savings (excepting the economic interest groups).

The dilution of the control power of the stockholders

Since in the case of the capital growth by issuing new stocks, the existing stockholders have a hostile attitude due to their decision taking power dissolution, to avoid this dissolution, as well as the derived risk, the company could prefer ordinary stocks instead of stocks with priority dividends, with no voting right or instead of investment certificates.

The technologic risk

So as the technical investment will not get overlaid by the technical process, the company, trying to maintain a high adapting ability, has to finance the most exposed investment by leasing, taking into consideration the fact that some leasing contracts stipulate the replacement of material or the execution of some adjustments before the end of the contract period.

The adapting of reimbursement methods at company's financial constraints

If the company has treasury difficulties, a loan that stands a delay (for instance two years is preferred instead of a loan that stands no delay, even though the second loan has a lower cost than the first.

The procedure of obtaining the loan

Since some loans need a longer and more complex procedure, and the company needs money to rapidly satisfy an offered opportunity, that it will opt for a more easy to obtain financing method.

The guaranties demanded to take loans

The availability of guaranties conditions the obtaining of many financing methods, thus, if the company will not be able to offer the demanded guaranties to obtain a specific loan type, it will have to choose other loan types, less exigent from the point of view of guaranties, but generally more expensive.

The judicial statute of the society

In the chapter which presented the financing methods we observed that only some specific financing methods are connected to the judicial statute of the company. For instance, only the companies from the public sector have access to participative titles, and only the capital societies can issue promissory notes etc.

The condition of the financial market

Mainly, if the financial market evolution is not good, this does not favor the title emissions, and companies have to find substituent financing, namely they will resort to bank credit.

The financial "classic" constraints (Sandu, 2002) imposed on the company

- **The rule of minimum financial balance:** Mainly, lasting business has to be financed by lasting resources. The compliance with this rule determines the choice between financing by sustainable resources and financing through short term credits. It may be said that we are talking about a first degree choice, because there is a second choice to be made, between elements of lasting resources or between the kinds of short-term credits.
- **The rule of maximum debt (or financial autonomy):** Total financial debts should not exceed the total own funds. This rule expresses the financial autonomy of the company (or the coefficient of indebtedness), and it can be expressed by the following formula:

$$\textit{Overall debt ratio} = \textit{Total debts} / \textit{Total passive} \leq 2/3$$

The factor from the fraction's numerator cumulates, of course, both long-term and medium term loans, and also short term debts, the indicator expressing, in the most general manner the general situation of the financial structure.

Another indicator of high financial expressiveness is obtained by reporting some component elements of the permanent capital of the balance sheet liabilities, and the debts on medium or long term, to the own capital, acquiring the indicator called on term debt coefficient (Toma, Alexandru, 2003).

$$\textit{Long-term debt coefficient} = \textit{Long-term debts} / \textit{Equity capital} \leq 1$$

or:

$$\textit{Long- term debt coefficient} = \textit{Long-term debts} / \textit{Permanent capital} \leq 1/2$$

In principle, if the financial liabilities are equal to or exceed the size of the own capital, the company cannot increase its debt. A debt higher to the total of company's capital can be obtained only by providing significant guarantees (mortgages, pledges), or accepting the situation in which the creditors exert a certain control over the management of the company. It is clear that in such a situation, the autonomy of the company is compromised.

- **The reimbursement ability rule:** The total financial debt should not be more than about three to four times the previewed average annual of self-financing capacity. This rule, as a complement to the, can be stated by the reasoning:

$$\textit{The duration of the self-financing ability} = \textit{Financial debts} / \textit{CAF} < 3 \textit{ (max. 4)}$$

It is estimated that this period should not exceed three or four years. Otherwise expressed, the company must have a self-financing capacity to satisfy at least 25% of the annual obligations arising from the outstanding rates, interests, bank charges and commissions. Theoretically, the company that did not follow this

rule cannot claim the increase of loans. In this case, the choice will be reduced to the personal capital and/or eventually to leasing.

- **The minimum self-financing rule:** The company has to self-finance a part (generally 30%*)* from the investment for which it demands the credit. If a company decides to finance by indebting an investment project, it will not receive a credit equal to 100% from the cost of the project will therefore have to find a complementary personal financing.

In conclusion, the selection of the company's financing modes is found under certain constraints that restrict the field of possibilities for financing, on one hand, and on the other hand, more choice criteria can be identified, which are adapted to different defined strategies.

Bibliography

1. Arnold, G., (2002) *Corporate Financial Management*, New York, Prentice Hall Financial Times
2. Block, B.S., Hirt A.G., (2005) *Foundations of Financial Management*, New York, McGraw-Hill
3. Bogdan I., (coordinator), (2002) *Treatee of Financial-Banking Management*, Bucureşti, Editura Economică
4. Fitzgerald R., (2002) *Business Finance for Managers*, London, Kogan Page Limited
5. Helfert E., (2003) *Techniques of Financial Analyses*, New York, McGraw-Hill
6. Hoanţă, N., (2002) *Company's Finances*, Bucureşti, Editura Economică
7. Hoanţă, N., (1996) *Company's Finances*, Sibiu, Editura Continent
8. Sandu, G., (2000) *The Forming of the Private Companies Capitals*, Bucureşti, Editura Economică
9. Samuels J.M., Wilkes F.M., Brayshaw R.E., (1995) *Management of Company Finance*, London, Chapman snd Hall
10. Teodor, H., (1999) *The Economic Agents Finance in Romania*, Deva, Ed. Intelcredo
11. Toma, M., F. Alexandru, (2003) *Finance and Financial Transaction of Enterprise* , Bucureşti, Editura Economică
12. Whiteley John, (2004) *Mastering Financial Management*, New York, Palgrave Master Series