FINANCIAL DECISIONS IN THE CONTEXT OF THE FINANCING OF CZECH COMPANIES IN AN INTERNATIONAL ENVIRONMENT

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Abstract: This paper deals with the evaluation of financial and non-financial indicators of small and medium-sized Czech companies with international activities using mathematical and statistical methods. The bases of interaction are the non-financial indicators of the international environment: international accounting standards and Czech accounting standards. Financial ratios are selected: ratio indicators, equity and foreign capital, venture capital and profit. By analyzing the data, the information is the key to the financial decision making on the type of financing. Conclusions of our own research confirm that Czech companies use universally known forms of financing, e.g. own capital. The use of czech venture capital lags behind other European countries is very slow moving to a real improvement.

Keywords: Small and medium-sized companies, financial indicators, non-financial indicators, financing, own sources, foreign sources, venture capital.

1 Introduction

At present, the international business environment is marked by big changes. There has been a significant shift of thought about the rating of the company from traditional indexes towards market value. If the company wants to successfully develop, it must monitor and continually assess the ability of management having a direct impact on company performance (Pavelková et al., 2012). It is appropriate to compare the results of the financial performance evaluation not only in the context of its development in time, but also for example according to CZ-NACE categorization codes, as the field of activity has an impact on financial and economic performance of firms (Santis et al., 2016). It is appropriate to examine the company performance evaluation also from the perspective of the categorization of business entities. From the perspective of business economics, we divide companies to small, medium and large companies. The term 'company' is absent from accounting, this term is replaced by the term 'accounting unit'. The categorization of an accounting unit is based on the European Union directive and its categorization (micro, small, medium and large accounting unit) is dependent on the implementation of the directive in the particular country. In accordance with the rules of the European Union (Recommendation 2003/361/EC, 2003), an enterprise is considered medium-sized if the number of employees does not exceed 250, the annual turnover EUR50 million and the annual balance sheet total EUR43 million, the classification limits for a small and micro enterprise are lower. The specifics of small and medium-sized entrepreneurship in the current market environment are analyzed by e.g. Mikušová (2013). Regular economic analysis in connection with financial decisions and the management of the company has become a common tool for businesses, which can speedily draw attention to emerging problems in specific areas of business, particularly in problems in the financial management of the company, whose eventual failure by the stakeholders and the shareholder may have a negative impact on both the profit and the future development of the company (Elliot et al., 2011). A positive relationship between entrepreneurial orientation and business performance was found out by studies Darko et al. (2016), Mugomo et al. (2016), Pomar et al. (2016) investigated, among other things, the influence of the company size, the subject of business and financing in the context of return on investment. The increasing share of international activities also influences the way the company finances itself. It is necessary to address the interrelationships of financial and non-financial indicators that are underlying information of the company's decision about the form of financing. The need for financing of businesses is caused both by the need to set up in business and in every period of business development. Each business entity must calculate the necessary amount of funds. Significant area of decisions is the source of financing of business activities, including investment decisions that affect the financial management in the context of funding sources. If a company has insufficient of its own funding sources or its resources are exhausted, than the enterprise is forced to obtain additional resources from the available forms of financing, most often foreign capital. Deciding on the structure of funding sources is one of the most important decisions of the enterprise and translates into cost of capital, reduction or increase of prices and margins, profitability indicators and the creation of resources for other business activities etc. It is necessary to emphasized that not all sources of funding of the SMEs may be used and are available to them. This limitation is due to: legislative changes in individual countries, the provisions of the Accounting Act and other regulations or simply unavailable, which can be used by, for example, only large listed companies, such as stock exchange (a bond issue and shares). In addition to the well-known forms of financing there is a growing importance in a riskier form of finance which is known as venture capital in the Czech Republic (Pomykalski, 2014; Sato, 2013; Příhodová et al., 2013).

The aim of the article is selected to use mathematical and statistical methods to analyze selected financial and non-financial aspects in relation to the form of financing small and medium Czech enterprises with international activities. Own research is focused on SMEs, which are forced to considerably streamline business processes, carefully manage risks and deliberately assess resources and funding methods in the context of international activities. Business activities are also influenced by international accounting harmonization. The need to maintain accounting records and prepare financial statements is caused by legislation, the requirements of the international environment and business partners. Selected financial indicators are profit, private and foreign capital and ratio indicators. Non-financial indicators are international accounting harmonization and Czech accounting standards.

1.1 Theoretical Framework

The choice of capital structure influences not only the degree of indebtedness, but also the amount of profit or the measure of operating leverage. When searching for the optimum resources to finance assets it is appropriate to respect the golden rule of balance sheet financing, which means that fixed assets are financed by long-term funds (own capital) and long-term foreign capital and current assets are financed by short-term resources. Dittmar (2004) found (who observed the financing structure of selected enterprises) that the ratio of representation of own and foreign sources depends on the subject and nature of the business activities of the analyzed subject. Businesses with growth potential choose a lower leverage ratio. Using debt financing is too conservative and the quantity of stable and profitable enterprises is very low (Strebulaev, 2007). Titman et al. (1988) stated that the determinants influencing capital structure include the collateral value of property, the tax shield, company growth, industry classification, size and profitability. Wald (1999) analyzed in detail the impact of corporate characteristics on capital structure. His results show that institutions are also important determinants of capital structure. Abora et al. (2009) conducted examined of the factors influencing the components of capital for small and medium-sized enterprises. Molinari et al. (2016) analyzed the mutual influence of the financial structure, liquidity and expansion of businesses in Italy, Khidmat et al. (2014) analyzed the influence of liquidity and solvency on profitability. The cost of capital comprises two components, the cost of external (debt) and equity. Modigliani et al. (1958) Analyzed in detail of the average total cost of capital. Aliyev-Ada et al. (2015) investigated the effect of interest rates on financing. Large enterprises have a higher debt ratio than smaller firms. The fact that the capital structure also affects the phase of the economic cycle, is confirmed by the conclusions of Rodriguez-Masseur (2016).

Many studies on the sources and methods of funding exist in theory and practice. The conclusions of each of the searches are very similar and indicate that the measures adopted thus far for

the support and financing of SMEs is not sufficient, and is only very slowly moving towards a genuine form of corporate financing. Problematic areas of financing are designated phases: planning, decision-making and business management, tax liability and the possibility of obtaining capital for the further development of SMEs. Development phase of an enterprise has an impact on the specific arrangements for financial management, forms of financing and tools used for the internationalization of the company, Fig. 1. Each stage of development has different characteristics that are manifested variously in international markets in both cash flow and management style and business development in international markets (Block et al., 2004; Dluhošová, 2008). The factors influencing the capital structure in micro, small and medium-sized enterprises in countries of Central Europe examined Mateev et al. (2013). Fundamental factors of internationalization in relation to business financing are the areas of: financial planning, decision making and management, reporting and accounting standards.

Figure 1: Influence of business processes on the internationalization of the company
Source: modified by the author, Block et al. (2004), Dluhošová (2008)

According to the different stages of company development the form and method of financing is defined (Machková, 2015; Marek, 2009). Financing through venture capital has grown in importance in the last decade. In spite of this there exists very few practical studies. Many forms of venture capital exist. The investor does not usually provide only financial resources, but usually becomes part of the business (Juřičková et al., 2013; Zinecker et al., 2013). They participate in business risk and have the same rights and responsibilities as a business owner. The development of venture capital in the Czech Republic is typified by managerial buyouts of profitable groups of large companies. The management of such groups requires takeover and self-management (Dvořák et al., 2008; Nývltová et al., 2007; Czech Invest, 2017). The professional literature describes venture capital differently and there exists a number of definitions. Venture capital can be considered as a subordinate name for, "private equity".

2 Methodology

The author's own research on sources of SME financing is for the period 2009-2016 and this research is continuing (Meixnerová et al., 2017). The primary objective of my own research is the analysis of financial decisions on the financing method of companies in the Czech Republic in the context of international activities. When analyzing the links between the indicators it is assumed, that the selected indicators have their information used and they are a necessary source of information for the decision-making activity on the form of financing the enterprise. Variables considered in the model are not static, but cointegrated. When variables considered in the model are not static, but cointegrated, we applied the error correction model is applied by error correction model (VEC model indicated, also referred to as the EC model). According to Hindsl et al. (2000) in a linear relationship can be expressed provided that the variables xt and yt are the first order and integrated by means of an error correction mechanism in the form:

$$\Delta y_t = \alpha_0 + \gamma_0 \Delta x_t + \eta\,(y_{t-1} - \beta x_{t-1}) + u_t, \; kde\; \eta<0 \qquad (1)$$

where β is the cointegration parameter. β type parameters describe the long-term cointegration relationship between variables entered into the so-called cointegration vectors of type (1, β)'. The paper model error correction to change the profit (Δvh) described by the equation:

$$\Delta vh_t = LevRatio_t,\; ROA_t\;,\; ROE_t\;, ROC_t\;,\; VK_t\;, CK_t,\; VC_t,\; IS_t,\; CS_t \qquad (2)$$

where indebtedness (LevRatio) is perceived as a temporary growth indebtedness (marked "minus"), which leads to increased profitability indicators (ROA, ROE, ROC) (marked "plus"). Use of foreign capital (CK) is cheaper (marked "plus"), venture capital (VC) (marked "plus") and equity (VK) (marked "minus") should not be used in greater amounts (quantities) than foreign capital. It is preferred to use international accounting standards (IS) (marked "plus") and Czech accounting standards (CS) (marked "minus") are not significant for the international environment. The economic model is formally written as follows:

$$VH = f\,(LevRatio_t,\; ROA_t\;,\; ROE_t\;, ROC_t\;,\; VK_t\;, CK_t,\; VC_t\;,\; IS_t,\; CS_t) \qquad (3)$$

$$VH = (-, +, +, +,\; -, +, +, +, -) \qquad (3a)$$

3 Research

Comparison of the venture capital of the European market with the US can´t be compared sufficiently yet. The European venture capital market is small. Fig. 2 definated EVCA (2016a) shows that the proportion of investment in venture capital in proportion to the gross domestic product for the year 2016 for the Czech Republic amounted to 0.002%, which is quite far from the European average, which amounts to 0.027%. Venture capital values have tripled in the Czech Republic compared to 2014 and it has been a strong year for venture capital (EVCA, 2016). In venture capital, a typical investment of profiling business is in activities which lead to product/service expansion to other markets or working capital in connection with rapid revenue growth. Investors are usually satisfied with minority stakes, as the usual functioning of a young companies is very often directly dependent on the personality of the owner and a stable management team is still being created. Most of the investors operate on a fund basis in the Czech Republic. However, the fund itself is preceded by a time when the fund's future fund manager must find sufficient financial resources to manage. The main venture capital investors are usually pension funds, funds of funds, state institutions, banks and family offices (under this term can be represented, in particular, wealthy individuals or families who could obtain funds from, for example, the successful sales of their companies, etc.). The typical investment duration is between 3 and 7 years. According to the analysis EVCA (2016), it can be stated that venture capital is mostly used by large enterprises. For SMEs, venture capital opens up new possibilities. Besides financial barriers SMEs must solve infrastructure barriers (small cooperation between enterprises, insufficient cooperation between enterprises and higher education and research institutions) or information barriers (insufficient information on technological opportunities, insufficient information when starting a business, etc.).

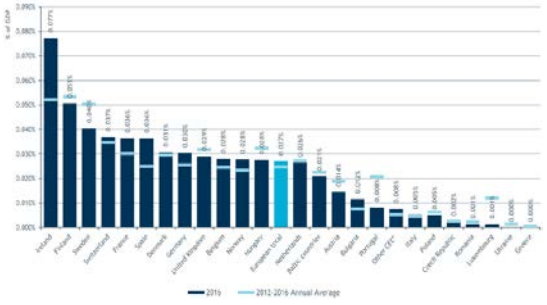

Figure 2: Percentage proportion of investment in venture capital in relation to GDP in 2016
Source: EVCA (2016a)

Fig. 3 shows a comparison of SMEs with international action to finance assets using foreign sources. The figure shows a positive trend of development, which means that companies finance their activities from foreign sources. The main motive of financing business activities by foreign resources is a relatively lower price in comparison to their own resources. These decisions on which funding metod is used is reflected in the profit and loss account. The growth in the value of the company in the international environment will depend on the achievement of positive results and the dynamics of sales.

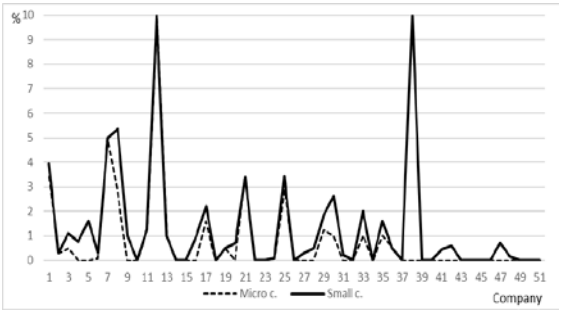

Figure 3: Comparison of indebtedness SMEs
Source: own research

The estimation of the VEC model for the detected cointegration binding is given in Tab. 1. An estimated VECM model is describes the short-term dynamics and the process of returning to balance. The long-term equilibrium relationship is interpreted using the cointegration vector. Normalized cointegrating vector VEC model ßt (vht, $LevRatio_t$, ROA_t , ROE_t ,ROC_t , VK_t ,CK_t, VC_t, IS_t, CS_t)´ is a predetermined limitations standardized so that the first component is the unit. The shape of the cointegration vector for profit is (1, -10.9808, 1.3092, 8.7774, 3.0644, 0.2897, -15.7610, 4.5697, 3.4575, -0.4745)´. From the values of coefficients R2 is shown the various degrees of tightness of dependence between the analyzed variables (indicators). It can be stated that the change of the dependent variables in the equation are 62.5% explained by changes in the independent variables and 37.5% of those changes are unexplained (Tab. 2). Given the character of the analyzed relationships is considered satisfactory we can say that we are able to adequately explain changes in profit and loss based on the selected indicators. The statistical significance of each variable in the equations was tested using t-statistics, and it is apparent that some of the delay values can be omitted in the model. The detected cointegration equation in comparison with the equation (2) proves that the "signs" of the coefficients in the cointegrating vector are in accordance with equation (3, 3a). The positive equity ratio (the opposite coefficient of the equation) shows that growth of equity by 1% causes a decrease in of the investigated dependent variable of about 0,2897%. The increase in own capital does not have a significant effect on profit or loss. It was also assumed the opposite effect of foreign capital, ie. that foreign capital should replace its own capital in a certain proportion. The impact of venture capital is small and the slow development of venture capital in small and medium-sized enterprises is confirmed. It can be stated that one´s private model could be extended for other variables, that would make the impact of equity in the long run more economically viable.

Cointegrating Eq:	CointEq1
vh(-1)	1.000000
levratio(-1)	-10.98087 ***
	(1.83990)
	[-3.86664]
roa(-1)	1.309265 ***
	(0.56521)
	[-2.31644]
roe(-1)	8.777465 ***
	(2.15265)
	[4.07751]
roc(-1)	3.064423 ***
	(0.90214)
	[-3.39683]
vk(-1)	0.289728 ***
	(0.16980)
	[-1.70631]
ck(-1)	-15.76105 ***
	(0.27464)
	[-6.92902]
vc(-1)	4,5697 ***
	(0.2564)
	[-3.02023]
is(-1)	3.457509 ***
	(0.17656)
	[-3.54050]
cs(-1)	-0.474571 ***
	(0.15074)
	[-3.14825]
C	-25.36453

*** Correlation is significant at the 0.001 level (2-tailed)
** Correlation is significant at the 0.01 level (2-tailed

Table 1: Estimation of VEC model for profit
Source: own research

Error Correction:	CointEq1
D(*vh*)	-0.624283 ***
	(0.06103)
	[-0.85907]
D(*levratio*)	0.000789 ***
	(0.00272)
	[0.29029]
D(*roa*)	0.032178 ***
	(0.03261)
	[0.98672]
D(*roe*)	0.010977 ***
	(0.00433)
	[2.53403]
D(*roc*)	0.030480 ***
	(0.00704)
	[4.33189]
D(*vk*)	0.133143 **
	(0.07069)
	[1.88351]
D(*ck*)	0.014713 **
	(0.00405)
	[3.63536]
D(vc)	1.065203
	(0.91604)
	[5.61042]
D(*is*)	-0.009648 ***
	(0.00763)
	[-1.26446]
D(*cs*)	0.096023 ***
	(0.07966)
	[1.20545]

*** Correlation is significant at the 0.001 level (2-tailed)
** Correlation is significant at the 0.01 level (2-tailed)

Table 2: Error correction of VEC model
Source: own research

Tab. 1 shows that the result of the VEC model has demonstrated the statistical significance of the correction component of the profit or loss model. The model is statistically significant and is capable of explaining short-term dynamics and convergence to

long-term equilibrium. Changes in the development of the economic result are explained by changes in the variables included in the model, which are in Tab. 1 marked in bold. It can be said that businesses use different forms of financing in relation to the profit. Management style and the size of the company, mostly for micro and small enterprises, have an influence on the form of financing. For micro and small enterprises the personal (ties or connections) predominate in the conceptual management system. Personal management style is not perceived as a threat in the context of decision-making and financing. Equity is, with regard to the risk, a credible form of financing. This confirms the conservatism of Czech entrepreneurs who understand the development of the company as a monitory value and not as a way or means for creation and development of the business.

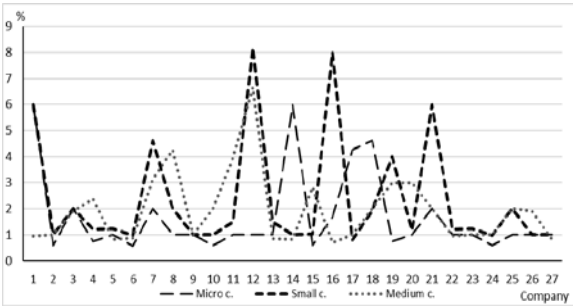

Figure 4: Return on assets by SMEs in year 2016
Source: own research

A comparison of the ROA level achieved and the average interest rate (discount rate in 2016, at the Czech National Bank (CNB) was 0.05% (CNB 2016)) shows that all large companies are able to receive and repay foreign sources, Fig. 4. For micro, small and medium enterprises a similar trend is shown. If we do not consider the effect of taxation, we can state that the SMEs would see only a change in the structure of foreign resources, which affects the development of ROA. SMEs are financing with foreign sources less actively, which can be caused by worsening conditions of availability of foreign resources, but also by the responsibility for managing the company on a "debt". It confirms that when reach the level of ROA and average interest rate, businesses would be able to receive and repay foreign sources. Adherence to the use of a certain proportion of foreign capital to finance the assets of a business should always correspond to the level of the company's liquidity and funding rules as it significantly affects the profitability of the enterprise. Other factors which affect the property and capital structure of the company are: capital costs, inventory, accounts receivable, interest, taxes, liquidity, dividend policy, risk, etc. The growing ROA trend shows the positive evaluation of equity, which is one of the most important indicators of the financial performance of the company for shareholders and prospective investors. The development of profitability indicators is similar and equally volatile in the observed enterprises. Trend indicators are continuously growing in time, see Fig. 5. The current trend of low interest rates (repro rate in year 2016, according to CNB was 0.05%) and excess of bank sources has an impact on the growth indicators of return on equity and can´t be described as a cause of disproportionate indebtedness of enterprises. The volatile development of the return on revenue ratio can be attributed to a well-established company strategy and a sufficient resilience of foreign sales to market developments. Growing sales and profit results tell of a healthy business. Companies that want to exist on the international market for a long time have to be reasonably profitable and must strive for a structure with minimal cost of own and foreign capital. However, profitability indicators are not a measure of the company's success because it does not reflect the risk of doing business, using foreign capital, liquidity or insolvency. The low level of funding with long-term resources and the high level of corporate inter-firm indebtedness is one of the major problems of managing the company's international activities.

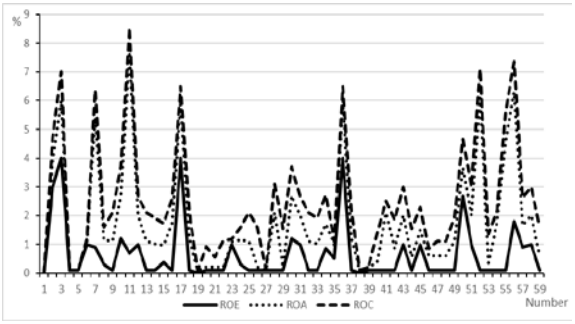

Figure 5: The development of profitability indicators in year 2016
Source: own research

4 Discussion

Examination of the variables laws and their interrelations confirmed the economic theory, which defines the interrelationships between the monitored indicators. Researching of the laws of variables and their mutual relations confirmed the economic theory that defines the interaction between monitored indicators. The development of profitability indicators for micro, small and medium enterprises is constant. That means that businesses are actively using the invested capital. The reason for the constant development of the return on equity is the stagnation of foreign resources for SMEs due to the cautious approach of banks, investors and other intermediaries on the basis of the global economic crisis in 2008-2009 and the historically high proportion of outstanding loans. The cause is that businesses are so small that they can´t offer a guarantee in the form of assets (fixed assets). Another influence is the change in the accounting methodology or the establishment of micro and small enterprises due to redundancies during the global economic crisis in the context of the establishment of new businesses without business and payment history. It is important to point out that not all sources of funding can be used by micro, small and medium-sized enterprises and that limited or no rights are created by the use of foreign capital by the business owner. Or, part of the production or business is provided to a foreign partner, which limits powers and is usually more expensive than a bank loan.

This confirm the well-known claim that micro and small businesses, from a lack of formation of own resources, which are wanting to increase the support of foreign resources who have an insufficient payment history will not gain it. An important role for companies with international equity ownership of the parent (due to the guarantee) is to provide financial resources under more favorable and more affordable terms. The optimal capital structure arises from the creation of a ratio of own and foreign capital with the lowest total capital cost. Decision-making on the way of financing an enterprise confirms the analysis of the impact of profitability, debt and capital management. Problem areas for micro and small businesses are to secure financial resources and their effective use in connection with limited bargaining power, limited classical and alternative sources of funding in relation to the duration of the operation on the international market and unequal access in taxation and tax treatment. The decision on how to finance the company affects the profitability, debt and capital management. It can be stated that due to the historical development of the Eastern economies their instead of is development status and use of financing through venture capital is lagging behind. The influence on decision-making and enterprise management in the context of financing confirmed the interdependence of accounting, tax and other legislative and financial aspects in the areas of:

- corporate activities (planning and decision-making, management, financing, etc.),
- market system,
- the use of financial analysis as part of the evaluation of corporate success in the domestic and international markets.

Non-financial indicators are growing in importance – the accounting harmonization process is overcoming existing differences between local accounting standards. The Czech Republic, if it wants to integrate into the global economy, must reconcile with this development. In addition to the knowledge of Czech accounting, the issue of international accounting harmonization, through the support of counseling, regional or higher education centers, or other knowledge-raising assistance, must be a matter for the general public.

5 Conclusion

Conclusions of own research confirm that Czech companies use generally known forms of financing: a combination of own and foreign sources. The problem area of an SME is to decide on the way of financing due to a lack of information, knowledge and legislative regulations. The use of venture capital lags behind other European countries and is very slowly moving towards real improvement. The basis for compiling international business plans and objectives, including defining and using funding sources, is business accounting analyzes that significantly affect the financial management of an enterprise. Above all, accounting is a control tool to analyze and document business activities in an international environment. Compliance with international accounting standards should ensure a comprehensive overview and full control of international business in the context of funding.

Practical research has been to design and identify appropriate variables that will influence decision-making in relation to business financing. Previously in this article, it was possible to work with data that had the character of non-stationary time series. The actual model variable in the contribution became the difference, not the original series of selected indicators, which motivated the creation of the VEC model. Long-term analysis has highlighted the fact that long-term relationships characterizing financial and non-financial areas exist among the selected indicators. The long-term equilibrium state was interpreted in the contribution by the cointegration vector in the VEC model. Certain identical impacts were identified, according to their own design, on the economic result. Nonetheless, the cointegration equations have unequivocally demonstrated and confirmed the view of the economic theory that with the growth of the economic result, the costs of using equity and the debt of the company are decreasing. This significantly influences the behavior and decision-making of an enterprise in the current competitive and international environment.

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