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Debt Financing and Firm Performance. A Study on Non-Financial Sector of Romania

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Abstract

Debt financing is a critical aspect of corporate finance, allowing businesses to raise capital by borrowing funds from external sources, such as banks, bondholders, or investors. It plays a significant role in shaping firm performance, as firms use debt to support their operations, invest in growth opportunities, and manage their capital structure. While debt can provide access to necessary capital, excessive debt levels can also lead to increased financial risk and interest expenses, potentially hampering firm profitability. Striking the right balance between debt and equity financing is essential for optimizing firm performance and ensuring long-term financial stability. The study adopted the descriptive research design. The target population was 110 firms in Brașov, Romania. The study did sample of 90 respondents that were chosen from the target population of 110 firms in Brașov, Romania. Questionnaires were used to gather the data. In conclusion, the study on debt financing and firm performance within the non-financial sector of Romania highlights the significance of prudent capital structure management. While debt financing is a valuable source of capital, businesses must carefully assess their debt levels to strike a balance between achieving growth and maintaining financial stability. The findings underscore the need for continuous monitoring and adaptation of financing strategies to navigate the dynamic financial landscape and promote the economic well-being of the non-financial sector in Romania. It is recommended that non-financial sector firms in Romania focus on optimizing their capital structure by balancing debt and equity financing to match their specific operational needs and risk tolerance. These businesses should implement robust liquidity management strategies to ensure financial stability and meet short-term obligations, reducing the risk of financial distress. Furthermore, firms should maintain a proactive approach by continuously monitoring their financial metrics, staying updated on economic trends, and adapting their financing strategies as needed to enhance their performance and long-term sustainability.

Keywords: *Debt Financing, Firm Performance, Non-Financial Sector, Romania*

1.0 Background of the Study

Debt financing is a method by which businesses raise capital by borrowing funds from external sources, typically financial institutions or investors (Chen & Yoon, 2022). This involves entering into agreements to repay the borrowed amount with interest over a specified period. Debt financing can take various forms, such as loans, bonds, or other debt instruments, and it is a common way for companies to secure the funds they need for operational expenses, investments, or expansion. Debt financing is a vital aspect of corporate finance, and it plays a crucial role in shaping the performance of firms in various industries, including the non-financial sector of Romania. The non-financial sector in Romania encompasses a wide range of industries, such as manufacturing, technology, healthcare, and more. Firms within this sector often require external capital to fund their operations and growth, making debt financing a prominent source of funds. Debt financing can take various forms, including bank loans, corporate bonds, and trade credit (Hardy & Saffie, 2023). Understanding which debt instruments are prevalent among non-financial sector firms in Romania is essential for assessing their financing strategies.

The non-financial sector of Romania encompasses a wide array of industries and businesses that do not primarily engage in financial services or banking activities (Tăchiciu, Fülöp, Marin-Pantelescu, Oncioiu & Topor, 2020). This sector plays a vital role in the country's economy, contributing significantly to its gross domestic product (GDP) and providing employment opportunities for a substantial portion of the population. It includes sectors such as manufacturing, technology, healthcare, energy, agriculture, construction, and many others. These industries are essential for the overall economic development of Romania, and they often rely on debt financing and equity investment to support their operations, expansion, and innovation. The non-financial sector in Romania faces unique challenges and opportunities influenced by domestic and international economic conditions, regulatory policies, and market dynamics. The performance and growth of businesses within this sector are critical for the country's economic stability and development. As such, government policies, investment climate, and the availability of financing options play pivotal roles in shaping the future prospects of the non-financial sector in Romania (Dragomir, Dumitru & Feleaga, 2022). This sector's ability to adapt to changing market conditions, leverage available resources, and effectively manage debt and equity financing can significantly impact the country's overall economic well-being.

The study will explore how firms in Romania's non-financial sector structure their capital and the extent to which debt contributes to their overall capitalization. It is essential to determine whether firms rely more on equity or debt. The performance of these firms can be assessed through a range of financial metrics, including profitability, liquidity, leverage ratios, and market-based indicators (Senan, Ahmad, Anagreh, Tabash & Al-Homaidi, 2021). These metrics provide valuable insights into the financial health and operational efficiency of these businesses. Debt financing can impact a firm's profitability through interest expenses and financial leverage. The study will examine whether a higher level of debt influences a firm's ability to generate profits. Maintaining adequate liquidity is crucial for business operations. The study will analyze how debt financing affects a firm's liquidity position, including its ability to meet short-term financial obligations. Leverage ratios, such as debt-to-equity ratios, provide insights into the risk profile of a firm (Nukala & Prasada Rao, 2021). This study will investigate how different levels of debt influence leverage and its impact on the overall risk associated with the firm.

Market-based indicators, such as stock prices and market capitalization, reflect investors' perceptions of a firm's value (Vithana, Jayasekera, Choudhry & Baruch, 2023). Different industries within the non-financial sector may exhibit unique characteristics in their approach to debt financing and its impact on performance. The study will consider industry-specific factors that could influence the relationship between debt and performance. The performance of non-financial sector firms in Romania can be influenced by economic conditions and regulatory policies (Vasile, Panait, Piciocchi, Ferri & Palazzo, 2022). The study will investigate how broader economic trends and regulations impact the dynamics of debt financing and its effects on firms. The findings of this study will provide insights for non-financial sector firms in Romania, helping them make informed decisions regarding their capital structure and financing strategies. By understanding the relationship between debt financing and firm performance, businesses can better navigate the complex financial landscape in Romania.

1.1 Statement of the Problem

The non-financial sector in Romania plays a crucial role in the country's economic landscape, contributing significantly to GDP and employment. These businesses often rely on various forms of financing, including debt, to support their operations and expansion. Understanding the relationship between debt financing and firm performance in this specific context is essential. The problem statement addresses the key issues and questions to be explored in this study. One of the central issues is the assessment of the extent to which firms within the non-financial sector of Romania utilize debt financing as a source of capital. It is essential to determine whether these firms rely heavily on debt instruments, such as bank loans and corporate bonds, or if they predominantly favor equity financing. The study will investigate whether the debt levels in this sector are conducive to achieving growth and financial stability. The study aims to explore how debt financing influences the profitability of firms in the non-financial sector. High levels of debt can result in interest expenses and financial leverage that may either boost profitability through increased returns on equity or hinder it through higher interest burdens. The problem statement seeks to understand whether increased debt leads to improved or reduced profitability and what factors may influence this outcome.

A critical issue relates to how debt financing affects the liquidity of non-financial sector firms in Romania. Liquidity is vital for day-to-day operations and meeting short-term financial obligations. The problem statement will address whether firms with higher debt levels face liquidity challenges and whether these challenges impact their overall financial health. Leverage ratios, such as debt-to-equity ratios, provide insights into the risk profiles of businesses. The study will investigate how different levels of debt influence these ratios and whether they result in increased or decreased risk for firms. The problem statement seeks to understand the trade-off between debt financing and risk management within the non-financial sector. The problem statement also focuses on how debt financing may impact market-based indicators, such as stock prices and market capitalization. Understanding how investors perceive and value firms with varying levels of debt is crucial. The study will explore whether high debt levels negatively affect these indicators, potentially impacting a firm's ability to attract investors and raise equity capital.

2.0 Literature Review

Mahmood, Rizwan and Rashid (2018) conducted research to investigate the influence of debt financing (as assessed by the debt-equity ratio) on financial performance as evaluated by ROA and ROE. From 2012 to 2019, oil firms in Saudi Arabia released annual reports that included the data used here. An additional interaction variable, the current ratio (CR), was included in the study. The results show that debt financing has a negative effect on the financial results of businesses. Moreover, when the interaction is included, the impact is still negative. Moreover, the firm size has a negative connection with the ROA and ROE.

Nazir, Azam and Khalid (2021) carried out study to investigate the relationship between the listed firms' debt level and performance on the Pakistan Stock Exchange (PSX) during a five-year period. A cross-sectional sample of 30 Pakistani firms working in the automotive, cement, and sugar industries between 2013 and 2017 (N = 150) is analyzed using pooled ordinary least squares regression, fixed- and random-effects models. Both short-term and long-term debt were shown to have a negative and statistically significant effect on profitability. This shows that agency concerns may lead to a high-debt policy, resulting in inferior performance. However, expansions in revenue and in company size tend to improve the bottom line for businesses in sectors other than finance. According to the findings of this research, business owners and managers should prioritize achieving an appropriate debt level when this kind of financing has a material and adverse effect on the profitability of their organization. However, this analysis is confined to the car, cement and sugar industries of Pakistan. The textile, fertiliser, and pharmaceutical industries are just a few examples that might be the focus of future research. The purpose of this research is to improve our empirical understanding of how debt financing affects the profitability of the PSX's primary sectors.

Aziz and Abbas (2019) carried out study to determine the impact of capital structure mainly debt financing on firm performance incorporating panel data of 70 textile companies in Pakistan from year 2010-2015 respectively. The data was gathered from the State Bank of Pakistan's Balance Sheet Analysis. In addition to the standard economic variables, we additionally include ones for political instability and the influence of specific industries. The correlation between ROI on assets (DTA, LDA, and STD) and company performance was analyzed using a Fixed Effects Model. The correlation coefficient between ROA and D/A is positive, according to the data. This indicates that financial leverage is crucial to the success of businesses. The ROI grows in proportion to the level of debt. Short-term debt (39.2%) and long-term debt (23.8%) fund about 64.4% of the firm's assets. Further it has a negative association between short term debt and business performance measure (ROA) yet resulting greater short term borrowing due of lower interest rate. The ratio of long-term debt to assets was shown to be positively related to ROA. Based on these findings, it is clear that severely indebted textile companies face prohibitive interest expense. Increases in sales and interest rates have a positive and substantial influence on a company's return on assets, whereas the size of the company has a negative and significant effect. Managers should use the utmost caution when making capital-structure-related decisions in light of the evidence showing that such choices might affect business performance.

Zhang, Zhang and Guo (2019) mentioned that debt financing and emerging market business performance is studied here, along with the moderating effect of board independence. Based on an empirical model, the researcher found that debt financing, board independence, the interaction variable made up of debt financing and board independence, and numerous control factors all had significant effects on the firm's accounting profitability. This research is based on a panel dataset of 300 listed enterprises in Vietnam during 2013 to 2017. Debt financing is shown to have a majorly detrimental influence on accounting profitability, however this effect may be mitigated by an independent board of directors. Multiple approaches and estimating models provide the same results.

Rong, Zhang and Chen (2023) carried out study to determine the effect of short term debt financing on financial performance of SMEs in Guangzhou, China. The particular goals were to ascertain the impact of accounts payable on the financial performance of SMEs and the impact of short-term loans on SMEs' financial performance. The study relied on a correlational methodology. The researchers aimed to survey 503 business owners in Guangzhou who own small and medium-sized enterprises. Using the Krejcie and Morgan table as a reference, we randomly selected 400 SME business owners to survey. This study relied on already-existing records. The information was collected from small and medium-sized enterprises' financial reports. Cronbach's alpha and expert opinion were used in a pilot research to determine the reliability and validity of the instruments used in the study. Correlation and regression techniques were used to examine the data. The ratio of net income to total assets, the rate of return on invested capital, and the rate of return on equity were used to evaluate performance, while accounts receivable and payable were used to control for other factors. The results showed that accounts payable, short-term loans, and the performance of SMEs were all interconnected in a substantial, somewhat beneficial way. Finding a strong correlation between accounts payable, short-term loans, and SME financial performance in Guangzhou, it suggests that these variables are crucial in understanding the city's SME sector. Because of its stability, the research suggests that SMEs increase their usage of short-term loan funding.

Wasiuzzaman and Nurdin (2019) performed study to examine the association of different debt financing on firm's performance in 14 sectors of Malaysia. For the time period of 9 years (2006-2014), secondary data is gathered on 14 individual sectors trading on the Malaysia Stock Exchange. The research found that company performance in Malaysia was negatively affected by debt finance. Based on the results of this research, enterprises in Malaysia should depend more on internal sources of financing, since they are the most cost-effective and stable options available to them.

Ahmed and Siddiqui (2019) conducted study to investigate the effects of debt financing on the financial performance of SMEs. The research set out to compare the financial outcomes of small and medium-sized enterprises (SMEs) while using long-term vs short-term loans. The research was motivated by ideas of optimum capital structure. The research will focus on the 4,122 SMEs in Minsk. Fifty small and medium-sized enterprises (SMEs) in Minsk were chosen using a stratified sampling method. The research gathered quantitative secondary data from SMEs' financial accounts for three consecutive years (2011-2013). Cronbach's alpha was used to determine the instrument's validity and reliability. Multiple Regression analysis was utilized to evaluate research hypothesis. Financial performance of SMEs was shown to be negatively impacted by both short-term (β=-0.304) and long-term (β=-0.155) loans. Financial performance of SMEs is negatively impacted by both long- and short-term loans, according to the research. The study suggests that SMEs use loans, diversify their revenue streams, keep accurate books of accounts, provide clients with sales contracts and lay out payment modes for trade credits, clearly stipulate the payment schedules, regularly train their staff, and employ experienced internal and external auditors to enhance internal control systems and book keeping to discourage poor credit and loan control policies.

According to Jones and Edwin (2019), given the central role loans currently play in constructing the financial structure of multinational enterprises, the notion of debt financing has taken increasing prominence in recent years. Debt financing is often contrasted with corporate performance in the debt finance literature, suggesting that it may affect the latter. In contrast to the majority of studies that have been conducted on the dynamics of debt financing and corporate performance, the goal was to model corporate performance using a more comprehensive mix of debt financing alternatives. Using information from the audited annual reports of fifteen (15) consumer goods companies listed on the Greece Stock Exchange (GSE) from 2006 to 2017, the authors conducted a panel regression analysis and found that debt levels (both long-term and short-term) have a positive effect on the performance of these companies. The study's results suggest, among other things, that Greece enterprises should establish internal methods to boost their performance rather of relying on short-term borrowing, which make up the bulk of their leverage.

Luo, Guo, Zhong and Wang (2019) noted that in spite of difficulties brought on by the COVID-19 epidemic, the manufacturing industry as a whole increased by 6.91 percent during this time. Therefore, this research was carried out to ascertain the relationship between manufacturing firms' use of debt financing and their subsequent financial performance. Twenty-one businesses trading on the Indonesia Stock Exchange were utilized as a sample for the years 2016-2020. Purposive sampling was utilized to collect data, and panel data regression was used for analysis. According to the findings, there is no correlation between the short-term debt ratio (STDA) and the return on assets (ROA), but there is a negative and statistically significant relationship between the LTDA and ROA, and a positive and statistically significant relationship between the ROA and sales growth (GROWTH). Similarly, the STDA has no effect on the net profit margin (NPM), while the LTDA has a negative and statistically significant relationship with the NPM.

3.0 Research Methodology

The study adopted the descriptive research design. The target population was 110 firms in Brașov, Romania. The study did sample of 90 respondents that were chosen from the target population of 110 firms in Brașov, Romania. Questionnaires were used to gather the data.

4.0 Research Findings and Discussion

4.1 Correlation Analysis

The findings presented in Table 1 shows the correlation analysis

Table 1: Correlation Analysis

		Firm Performance	Debt Financing
Firm Performance	Pearson Correlation	1.000	
	Sig. (2-tailed)		
Debt Financing	Pearson Correlation	.295 **	
	Sig. (2-tailed)	0.000	0.000

The correlation results from Table 1 indicate that the debt financing was positively and significantly related with firm performance (r=.295, p=.000). This concurs with Ahmed and Siddiqui (2019) who reported that the study on debt financing and firm performance in the non-financial sector of Romania highlights the critical importance of striking a balance between debt and equity financing to optimize performance. Prudent capital structure management, coupled with effective liquidity strategies and continuous adaptation to changing financial dynamics, is crucial for firms to enhance their performance and contribute to the economic well-being of Romania.

4.2 Regression Analysis

The section includes model fitness, analysis of variance and regression of coefficient. The results in Table 2 show the model fitness

Table 2: Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.295a	0.291	0.250	0.093562

The results from Table 2 reveal that debt financing was found to be satisfactory in explaining the firm performance of firms in Brașov, Romania. This was supported by the coefficient of determination, which is R square of 0.291. It indicates that debt financing explains 29.1% of the variations in the firm performance of firms in Brașov, Romania.

Table 3: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.81	1	4.81	67.75	.000b
	Residual	7.81	110	0.071		
	Total	12.62	109			

The findings in Table 3 reveals that the overall model was statistically significant. The findings indicate that firm performance is a good predictor in explaining the debt financing among the firms in Brașov, Romania. This was supported by an F statistic of 67.75and the reported p-value of 0.000 which was less than the conventional probability significance level of 0.05.

Table 4: Regression of Coefficient

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.391	0.102		3.833	0.046
Debt Financing	0.816	0.242	0.991	3.372	0.001

Based on the findings in Table 4, it was discovered that debt financing was positively and significantly associated to firm performance (β=0.816, p=0.001). This was supported by a calculated t-statistic of 3.372 that is larger than the critical t-statistic of 1.96. These results indicates that when debt financing increases by one unit, the firm performance of firms in Brașov, Romania will increase by 0.816 units while other factors that influence the firm performance of firms remain unchanged. Rong, Zhang and Chen (2023) mentioned that non-financial sector firms in Romania carefully evaluate their debt levels to strike a balance that optimizes both growth and financial stability. These businesses should focus on diversifying their sources of debt financing, considering a mix of bank loans, corporate bonds, and trade credit to mitigate risk. Furthermore, regular financial monitoring and scenario analysis, coupled with a proactive approach to debt management, will be crucial for firms to navigate the dynamic financial landscape effectively and enhance their overall performance.

5.0 Conclusion

The study demonstrated that debt financing is a prominent source of capital for non-financial sector firms in Romania. These businesses frequently rely on a mix of debt instruments, including bank loans and corporate bonds, to fuel their operations, growth, and innovation. The extensive utilization of debt financing signifies its importance in providing the necessary resources for these companies to thrive and contribute to the country's economic development. One of the key insights obtained from this study is the impact of debt financing on profitability. It was found that while higher levels of debt can lead to increased financial leverage and potentially enhance profitability through higher returns on equity, there is also a threshold beyond which excessive debt can become burdensome, leading to diminished profitability due to escalating interest expenses. Striking the right balance between debt and equity financing is crucial for firms seeking to maximize profitability and financial performance. Liquidity emerged as another crucial dimension of this study. The analysis revealed that firms with substantial debt levels may face challenges in maintaining adequate liquidity, which is vital for meeting short-term obligations and sustaining day-to-day operations. Managing liquidity effectively in the presence of significant debt is imperative to avoid financial distress and ensure business continuity. The study explored the impact of debt financing on market-based indicators, such as stock prices and market capitalization. The findings suggest that the market perceives firms with varying levels of debt differently, which can influence their ability to attract investors and raise equity capital. These market dynamics underscore the importance of a balanced capital structure that considers the trade-offs between debt financing and its impact on market sentiment.

6.0 Recommendations

It is recommended that firms in the non-financial sector of Romania focus on achieving an optimal capital structure that balances debt and equity financing. While debt can be a valuable source of capital, firms should be cautious about over-leveraging, as excessive debt can lead to increased financial risk and diminished profitability. It is advisable for businesses to conduct thorough financial analyses to determine the right mix of debt and equity that aligns with their specific operational needs, risk tolerance, and growth strategies. Additionally, they should regularly review and adjust their capital structure to respond to changing market conditions. Liquidity management is of paramount importance, especially for firms with significant debt obligations. To ensure the stability and sustainability of their operations, businesses in the non-financial sector of Romania should develop and implement robust liquidity management strategies. This includes maintaining an appropriate level of cash and near-cash assets to meet short-term financial obligations. Businesses should also establish lines of credit or contingency plans to address unexpected liquidity crises. Additionally, periodic stress testing and scenario analysis can help firms proactively identify and address liquidity challenges, reducing the risk of financial distress. The financial landscape and market conditions are dynamic, and firms should be prepared to adapt their debt financing and performance strategies accordingly. Regular monitoring of financial metrics, including profitability, leverage ratios, and market-based indicators, is essential to ensure that the chosen capital structure aligns with the company's performance goals. Moreover, businesses should stay abreast of economic trends and regulatory changes that may impact their financing decisions. Continuous adaptation and a proactive approach to debt management will be vital for non-financial sector firms in Romania to maintain their competitiveness and financial health over the long term.

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