THE IMPACT OF THE FINANCIAL CRISIS ON INDEBTEDNESS AND STOCK EXCHANGE QUOTATION — A CASE STUDY

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Abstract: This paper aims at making an analysis of the impact of the financial crisis on the Romanian company Albalact S.A., by using indebtedness and profitability indexes as well as stock exchange quotations, and taking into account the data provided by the financial statements of this company and the trend of its shares on the stock market during the period 2007-2009. It is seen that the crisis has influenced to some extent the earnings and, subsequently, the stock exchange quotation of the company.

JEL classification: G01, G32

Key words: financial crisis; indebtedness; stock exchange; capital structure

1. Introduction

In the Romanian economic environment, the final criterion of assessment of a company’s efficiency, from the point of view of the shareholders and managers, is the return of equity. The latter must bring satisfaction to the shareholders’ needs, taking into account the potential risk. For each category of financial sources, on the one hand, and for the whole amount of invested capital, on the other hand, there is a series of associated rates of return. Thus, the equity capital is in correlation with the financial rate of return, debts are in correlation with the interest rate, and the invested capital is in correlation with the economic rate of return.

The relation between the financial structure, indebtedness and economic efficiency is established by the financial leverage effect. Generally speaking, the financial leverage effect measures the impact of the financial structure on the firm’s net profit and on economic efficiency. The financial leverage is calculated according to the ratio between loan capital (total debt) and equity, while the effect of financial leverage, by the formula $(ERR - i) \frac{Loans}{Equity}$.

The financial and economic crisis originates from outside Romania, and therefore an internalization process takes place within the economy and society of this country. The international financial crisis affects Romania through events such as the rise in the price of external financing, the sudden movements in the national currency and the reduction in the price of the shares sold on the stock market. At a microeconomic level, companies don’t have the same outlet, as a result of the decrease in the demand for products and services, they have greater difficulties in obtaining
loans for the financing of their activity (because of harsher conditions for taking out loans) and when they manage to obtain loans, financial expenses are higher, because of the increase in interests for the granted loans. Even in respect of the firms whose dependence on banks is not heavy, all these causes are sufficient to reduce the efficiency of the activity. This reduction of the activity triggers, in turn, a reduction in the stock exchange quotation for the company in question. The stock exchange quotation is obtained, as any other price, by comparing the demand (the number of investors who want to have that particular share and are willing to pay for it) with the offer (the number of shares issued by the company). When a company is expected to record losses, the value of the share drops, and when the company has had solid results over the last years, investors are willing to pay more.

2. Objectives

This paper aims at making an analysis of the impact of the financial crisis on the Romanian company Albalact S.A., by using indebtedness and profitability indexes, as well as stock exchange quotations, taking into account the data provided by the financial statements of this company and the trend of its shares on the stock market during the period 2007-2009.

3. Methodology

On basis of the financial statements for 2007, 2008 and 2009, posted on the website of the Bucharest Stock Exchange, we shall analyze the global indebtedness, the rates of return and the trend in the stock exchange quotation for the company Albalact S.A. This company had a positive value of profit during all the three years (even increasing in 2009 in comparison to 2008), took out both short and medium and long term debts and transactions with its shares on the stock market were not interrupted during the analyzed period.

We shall consider the interest rate (i) at the average value for the credit facility, according to the data provided by the National Bank of Romania for years 2007, 2008 and 2009. For simplification, we choose to make an annual average of the interest rates used by credit companies, posted on the National Bank's website, for new loans granted to non-financial companies, and we obtain a rate of 14.45% for 2007, 15.63% for 2008 and 15.22% for 2009.

4. Analyses

Pursuant to the analysis of the financial statements of the company Albalact S.A., we determined the following indicators of indebtedness and return:

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We can notice that Albalact S.A., the analyzed company, recorded an increase in the rate of indebtedness between 2007 and 2009, partially because of the reduction of the economic and financial efficiency. The company’s new loans, which increased its
rate of indebtedness by 7%, led to the reduction of the rates of return, and the financial leverage effect, already negative in 2007, decreased even more seriously in 2008. Subsequently, in 2009, the degree of indebtedness increased even more, debt representing more than half of equity and, even though rates of return increased slightly (due to the increase in the operating profit), the financial leverage effect still was negative, even in decline in comparison to the previous year. Even though a part of the newly taken loans are operating debts, the dependence on the banks is getting heavier, through financial debts, both on the short and long term. The company’s reports show, for 2009, an increase of more than 50% both in short-term and long-term debts, due to the increase in the credit line and a new loan from BCR (Romanian Commercial Bank), in order to purchase the majority block of shares of another company.

The financial rate of return decreases in 2008 in comparison to 2007 and it does not have a satisfactory level, being far from the average value of the interest on the deposit facility (between 9 and 10% for the three analyzed years, according to the data provided by the National Bank), so that investments in the company for obtaining profit are not justified, it may even be expected that the shares of Albalact S.A. should be sold at very low prices.

The economic rate of return, also dropping, is by far inferior to the interest rate on the credit facilities. The firm cannot succeed in covering its financial expenses through the obtained economic efficiency, and the financial leverage effect is a negative one.

Moreover, the stock exchange quotation collapsed starting from the month of August 2007 until the first quarter of 2009 (when we can observe a slight increase), according to the data provided by the Bucharest Stock Exchange in the following chart:

![Figure no. 1](http://www.bvb.ro/ListedCompanies/EmitGrafic.aspx?s=ALBZ)

We can observe, hence, how the stock exchange quotation of Albalact S.A. was influenced by the delicate situation of the firm. The poor economic performance, reflected in the decreasing rates of return, resulted in a net profit 5 times lower in 2008
than in 2007 (606,580 lei compared to 3,236,030 lei), which pushed away the investors, who preferred to invest in more profitable companies, whose economic efficiency was higher than the medium interest rate on the market. In 2009, the company’s quotation had a somewhat increasing trend (which also materialized in an ascending profit). In order to overcome this situation it is recommended to use carefully own resources, still stable enough to eliminate the negative effects of an additional indebtedness, which would worsen the status of the firm and plunge it deeper into debt. Although, in essence, taking out loans can be an incentive for the activity of a firm, in this firm’s case the economic crisis hit it severely, and the borrowed capital is not a solution. It is therefore recommended to use own stable resources, in order to increase the efficiency of the activity, so that the financial leverage can be re-launched later on and so as to benefit in the future from the leverage effect.

5. Conclusions

It can be seen, on basis of this case study, that the situation of a company clearly influences its stock exchange quotation. Poor economic performances drive investors away, whereas trends of growth attract them and determine them to invest in a certain company. Therefore, companies affected by the financial crisis will barely find support from their investors in these times of difficulties and will have to resort to other resources in order to recover and develop.

REFERENCES

5. * * * http://www.bvb.ro