Self-financing and debt financing capabilities of small and medium-sized enterprises

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ABSTRACT

This study aims to study the financial capacity of small and medium-sized enterprises in terms of self-financing capacity and debt financing capacity. The authors use both qualitative and quantitative research methods. The results show that the financial capacity of small and medium-sized enterprises in terms of self-financing capacity and debt debt financing capacity includes self-financing capacity (self-financing ratio, long-term asset self-financing ratio, and fixed asset self-financing ratio) and debt capital mobilization capacity. In which, in the period of 2018–2022, the self-financing ratio is from 0.35 to 0.42, the long-term asset self-financing ratio is from 0.6 to 0.77, and the fixed asset self-financing ratio is from 0.78 to 0.85. The debt capital mobilization capacity of microenterprises is from 0.8 to 1.0; the debt capital mobilization capacity of small enterprises ranges from 1.4 to 1.8; and the debt capital mobilization capacity of medium enterprises ranges from 1.8 to 2.5.

Keywords: Business administration, financial capapbility, Self-funding capacity, debt financing capacity, small and medium enterprises (SMEs), business performance

JEL codes: M10, L66, M21, L25, D24, F65

1. INTRODUCTION

Additionally, business owners have demonstrated that SMEs, as a subset of entrepreneurship, have the capacity to boost the nation's economy in terms of both quantity and quality (Parmitasari & Rusnawati, 2023).

Recently, the People's Committee of Hanoi and the government have put into place a synchronized policy structure that helps small and medium-sized businesses access resources and thrive by fostering an atmosphere that is conducive to business. Nonetheless, most companies that struggle to obtain lending capital are recently founded companies. Following the epidemic, small enterprises with restricted financial resources and managerial expertise are currently recuperating. Many businesses still struggle to make ends meet when it comes to paying off all of their restructured and past-due obligations (Dao Tuyet, 2023).

In the process of developing a market economy, with fierce competition between domestic and foreign enterprises, SMEs are facing great opportunities and challenges. To be able to stand firm in the market, each SME must have strong financial capacity. Improving financial capacity for SMEs is one of the urgent requirements in the current integration context. Improving financial capacity in general and improving self-financing capacity and debt capital mobilization capacity in particular will help SMEs to apply modern construction science and technology, improve working conditions, increase labor productivity, improve business performance, and increase the competitiveness of SMEs in the current conditions in Vietnam.

2. LITERATURE REVIEW AND THEORETICAL BASIS

2.1. Financial capapbility

The Balanced Scorecard Model (BSC) is a key component of management accounting theory, having been developed by Kaplan and Norton (1992). In addition to standard metrics like measuring financial outcomes and breaking the business field down into four components (finance, customers, internal processes, and learning and development), BSC offers a holistic perspective on measuring an organization's business results. Goals, targets, expected outcomes, and action plans are given for each area. The company's financial outcomes are tracked and measured in accordance with predetermined objectives.

2.2. Self-funding capacity

Self-financing capability (equity ratio) is the ability of SMEs to use the owner's capital to serve production and business activities. Owner's capital is the capital owned by SMEs, including the owner's capital and the additional capital from business results. This indicator is determined according to the following formula:

$$\text{Equity ratio } = \frac{Equity}{Total\ capital\ (or\ Total\ assets)} * 100\%$$

This indicator reflects the capital owned by the SME owner; the SME has the right to own, decide, and use long-term in business activities. In which, total equity is the current equity of the SME, reflecting the total equity of the enterprise, showing the financial capacity of the owner to meet the activities of the enterprise.

A high equity ratio shows that the enterprise is financially independent, highly financially autonomous, has low financial risk, does not utilize financial leverage, and has low capital performance.

This indicator reflects the ability to mobilize equity capital to finance the assets of the enterprise. The higher this indicator, the greater the ability to mobilize equity capital to finance assets, and the higher the financial capacity of the enterprise. In the source of equity capital, the endogenous equity capital is the "internal" capital source of the enterprise. Using this source of capital can be said to bring the highest level of safety to the enterprise. Mobilizing equity capital from external sources for joint stock companies also has many advantages for the enterprise, but the biggest disadvantage is that the enterprise must accept to share the right to manage, control, and share high income. When mobilizing capital from this source, the owner must accept to share many of his benefits. In many cases, control of the company is lost. Moreover, to raise capital from external equity, the enterprise must satisfy certain conditions.

For that reason, in the equity capital, internal equity capital is highly valued because this capital source will help the enterprise grow sustainably. To consider the ability to raise capital from internal equity capital, information users usually use the following criteria:

$$\text{Retained earnings reinvestment rate} = \frac{\text{Profits left over from investment}}{\text{Net Profit}} * 100\%$$

This indicator shows how much of every 100 dong of net profit the enterprise retains for reinvestment. It reflects the enterprise's ability to mobilize equity capital from retained earnings. This is part of the endogenous financial capacity of the owner. The higher this indicator is, the higher the ability to mobilize equity capital from net profits, the greater the enterprise's ability to self-accumulate. This helps ensure the enterprise's financial capacity and vice versa.

$$\text{Endogenous growth rate} = \frac{\text{Retained earnings for reinvestment}}{\text{Total assets}} * 100\%$$

This indicator shows that the endogenous growth rate has a close relationship with the rate of retained earnings for reinvestment, the ability to self-finance, and the business efficiency of the enterprise. Thus, the higher the rate of retained earnings for reinvestment, the greater the efficiency of using the enterprise's equity capital, and the higher the ability to self-finance, the more the endogenous growth rate increases.

When assessing the self-financing capacity of a firm, information users will be interested in the self-financing ratio of that firm. This ratio reflects the proportion of equity capital to the total assets of the firm. Determining the appropriate level of equity capital in the capital of a firm will depend largely on the activities and policies of each firm as well as each industry.

The self-financing ratio is an indicator that reflects the financial self-sufficiency and financial autonomy of an enterprise. This indicator shows how much of the total capital source to finance the enterprise's assets is equity capital.

The larger the value of the indicator, the higher the financial self-sufficiency, the higher the financial independence of the enterprise, and vice versa, the smaller the value of the indicator, the lower the financial self-sufficiency of the enterprise, the lower the financial independence of the enterprise. However, when the self-financing coefficient is high, it also shows that the enterprise has not taken advantage of financial leverage much.

Self-financing ratio = owner's equity/total capital sources;

Long-term asset self-financing ratio (or equity to long-term assets ratio) is an indicator reflecting the ability to cover short-term assets with equity. This indicator is determined as follows: Long-term asset self-financing ratio = equity/long-term assets.

A fixed asset self-financing ratio (or equity ratio on fixed assets) is an indicator reflecting the ability to meet the fixed asset part (already and being invested) with equity. Fixed asset self-financing ratio = equity/fixed assets already and being invested.

2.3. Debt financing capacity

Debt capital mobilization is also an important criterion to evaluate the financial capacity of SMEs. Debt capital mobilization shows the ability of SMEs to have more capital and more assets from SMEs and other entities to conduct production and business. SMEs can mobilize from many different sources, such as loans from commercial banks, financial institutions, financial leasing, bond issuance, supplier credit, etc. This is a criterion to evaluate the capital mobilization ability of SMEs and is shown through the following indicators:

$$\text{Debt financing capacity or debt ratio} = \frac{\text{Debt capital}}{\text{Total assets or total capital}} * 100\%$$

This indicator reflects the financial capacity of SMEs from debt capital. The higher this indicator, the greater the ability to finance assets from debt capital, the greater the financial capacity of SMEs. However, when using this indicator to evaluate the financial capacity of SMEs, it is necessary to combine it with indicators to evaluate the ability to ensure financial safety. Because the higher this indicator, the greater the financial risks for the enterprise. This indicator shows how much capital the SMEs mobilize from other sources out of 100 VND of capital that SMEs are using for production and business activities. This indicator shows the use of debt by SMEs in organizing capital sources as follows:

Reflects the financial capacity of SMEs or the financial autonomy of SMEs. A low debt ratio reflects high financial autonomy.

Reflects the level of high or low financial leverage. A high debt ratio reflects a high level of financial leverage.

Reflects the level of risk of SMEs. A high debt ratio reflects low payment ability.

Reflects the level of risk acceptance of leaders and managers of SMEs.

Reflects the ability of SMEs to continue to mobilize capital from outside; a high debt ratio means difficulty in borrowing more.

The liabilities of SMEs are the amount of money that the enterprise borrows to supplement the capital shortage and the liabilities arising from payment transactions. The liabilities of SMEs include: loans from commercial banks and financial institutions; debts payable to suppliers; corporate bond debt; cyclical debt; and some other debts.

When considering the ability to mobilize debt capital of enterprises, within the framework of this thesis, the author will consider the debt index of SMEs, used to measure the level of financial risk, indicating the level of damage to creditors when the enterprise is unable to pay (bankrupt).

Debt index = average total debt of the enterprise / average equity of the enterprise.

3. RESEARCH METHODS

The secondary data used in this study were taken from SMEs' reports.

Studying the financial capability of small and medium-sized businesses in Hanoi is highly intriguing as it can offer more profound understanding of the challenges encountered by investors in the region.

This research relies on a theoretically descriptive method, and as a result, an applied statistical and standard strategy that makes use of various statistical tools, quantification, and estimation.

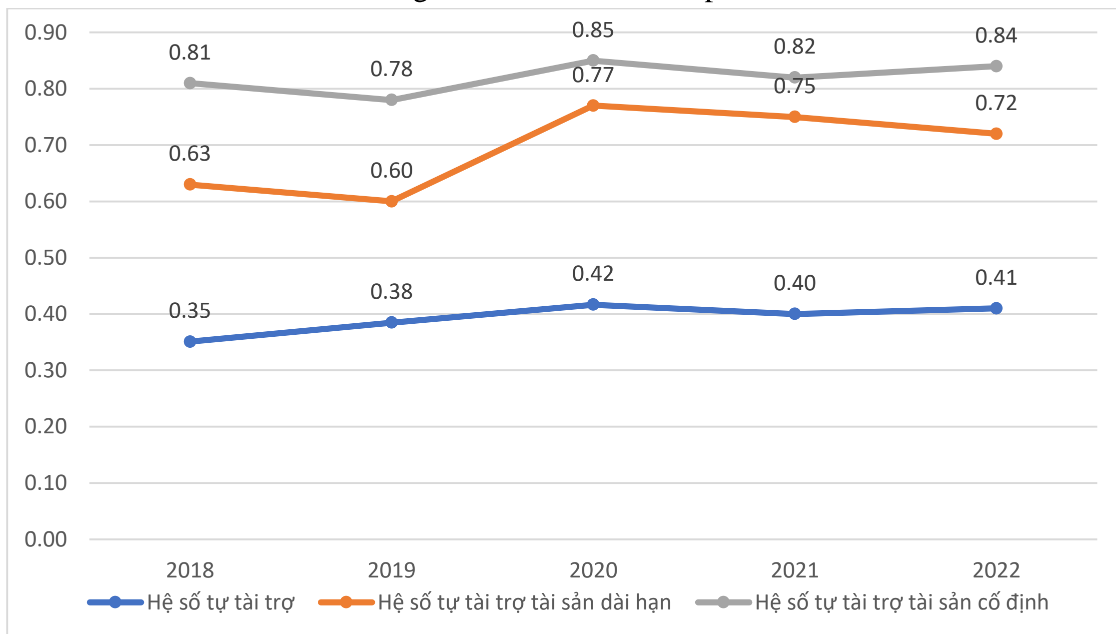
The study population consists of small and medium enterprises in Hanoi, Vietnam. The study was conducted in 2023 and 2024.

We use qualitative research methods and quantitative research methods. Based on the reports of SMEs.

4. RESULTS

4.1. Self-funding ability of SMEs

Chart 1: Self-financing ratio of SMEs in the period 2018-2022



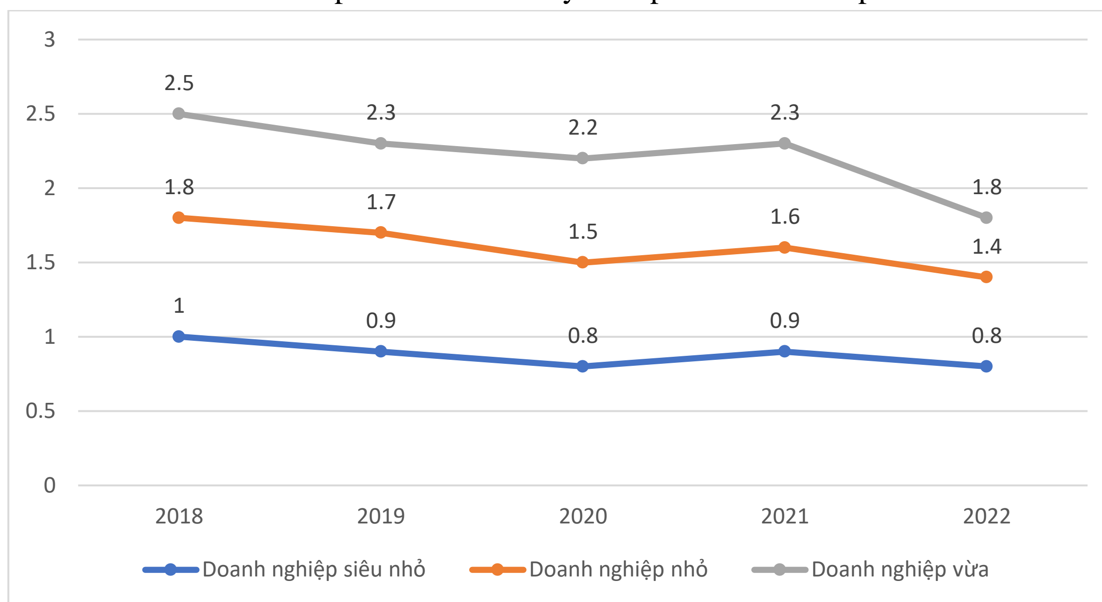
Source: General Statistics Office and author's calculations

The chart above shows that the self-financing ratio of SMEs in the period 2018–2022 has not changed much. The owner's equity of the enterprise has not increased much in correlation with the total capital mobilized by the enterprise, including both owner's equity and debt capital. The self-financing ratio of SMEs is always below 0.42, showing that owner's equity is still a major and extremely important source of capital for SMEs, which shows that SMEs are not making good use of financial leverage.

The two coefficients of self-financing of long-term assets and self-financing of fixed assets of SMEs are in the range of 0.6 to 0.85, showing that most of the long-term and fixed assets of SMEs are financed from the enterprise's equity capital. This, although it will reduce the risk for the enterprise, contributes to limiting the ability to expand the scale of production and business activities of small and medium enterprises. When the enterprise wants to increase assets, it must mobilize the owner's own capital; this source of capital is often limited due to the limited financial capacity of the enterprise owner.

4.2. Debt financing capacity of SMEs

Chart 2: Debt index of enterprises classified by enterprise size in the period 2018-2022



Source: General Statistics Office and author's calculations

The debt ratio of SMEs tends to decrease over the years and according to the size of the enterprise. Medium-sized enterprises have the largest debt ratio among small and medium-sized enterprises at 1.8 to 2.5, while small-sized enterprises have a debt ratio of 1.4 to 1.8 and micro-sized enterprises have a debt ratio of 0.8 to 1. The debt ratio decreases gradually according to the size of the enterprise, showing that the smaller the enterprise, the less well it can mobilize loan sources, and the ability to use funding sources is not effective.

5. DISCUSSION AND IMPLICATIONS

In the market economy, the methods of debt capital mobilization of SMEs are diversified to exploit all capital sources in the economy, including:

Borrowing from banks: this is a very important capital mobilization channel for SMEs. Bank credit loans are classified according to many criteria and are often classified as short-term loans (under 12 months) and long-term loans (over 12 months). In order to borrow capital from credit institutions, SMEs need a guaranteed profile. In developed countries, credit assessment and rating are carried out carefully by professional companies.

In Vietnam, due to the low level of education, credit rating is still subjective, usually done by the bank's credit department, and the credit history of SMEs is an important factor in creating trust for the bank.

Issuing bonds is a form of borrowing in which the borrower issues a certificate, usually with a fixed interest rate, ensuring payment within a specified period of time in the future. The result of issuing bonds is to increase the company's loan capital. This is an effective method of raising capital for small and medium enterprises that need to raise capital at an appropriate interest rate, lower than the bank loan interest rate but higher than the savings deposit rate to attract investors. Currently on the market, companies often use two main types of bonds: regular bonds and convertible bonds.

Commercial credit capital is a source of capital formed when SMEs temporarily occupy and use it before the payment deadline to creditors. This is a relatively important source of capital in SMEs. This source of capital comes from SMEs occupying money from suppliers or creditors. This occupation may or may not have to be charged a fee, but it meets the need for SMEs to have raw materials, electricity, and water to produce and do business while only having to immediately spend an amount of money less than the amount of money spent under normal production and business conditions. Thus, SMEs can use their cash fund for other purposes.

Financial leasing, also known as capital leasing, is a medium- and long-term irrevocable credit financing method. Under this method, the lessor usually purchases assets and equipment at the request of the lessee and holds ownership of the leased assets. The lessee uses the leased assets and pays the rent during the agreed term and cannot cancel the contract before the due date. At the end of the lease term, the lessee can transfer ownership, buy back, or continue to lease the asset depending on the conditions agreed in the lease contract. According to the International Accounting Standards Committee (IASC), any transaction that satisfies one of these four standards is considered a financial lease:

Ownership of the asset is transferred to the lessee at the end of the lease.

The lease includes an option to purchase the leased asset at the end of the lease.

The lease term is for the major part of the asset's useful life.

The present value of all minimum lease payments due to the lessee is at least equal to or greater than the fair market value of the asset at the time the lease is entered into.

Capital expansion solution: In the coming years, to expand business scale and market, capital expansion is necessary. SMEs should build a sustainable development strategy as a basis and orientation for all production and business activities. Complete and promote the effectiveness of planning in areas such as market, investment in equipment and technology, raw materials, labor and wages, and financial planning, and from there accurately determine the needs for each type of capital to ensure the production and business process. Effectively exploiting capital sources that SMEs can access, such as internal capital from funds, shareholders... and external capital sources, such as trade credit, bank credit, customer advances, asset leasing credit... Using capital economically in production and business stages to reduce capital needs and capital costs is the basis for increasing profits and capital efficiency of SMEs.

Improve the efficiency of fixed capital use: Reduce the proportion of fixed capital not used in production and business to make the most of existing fixed capital. Adjust fixed capital among member units to serve business more effectively. Proactively transfer and sell all unused fixed capital to recover capital. Proactively liquidate damaged and outdated fixed capital that cannot be transferred or sold or cannot be restored. For temporary fixed capital not in use, it is advisable to lease, pledge, or mortgage to mobilize investment capital in other areas.

Practically speaking, the study's findings help managers better appreciate how crucial it is for them to make decisions on how to increase their financial capacity. The world has changed significantly as a result of the COVID-19 epidemic, and society as a whole is embracing digital revolution. SMEs must increase their ability for innovation in order to transform their business practices and produce new goods. Enhancing the business performance of the organization can be achieved through utilizing knowledge from the network and adjusting to the environment based on market orientation.

Furthermore, in light of the effects of regional economic integration and globalization, a firm's competitiveness and ability to adapt to changing consumer preferences depend heavily on its capacity to recognize and adapt to market developments.

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