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**Does the Profitability Have an Influence  
on the Financing Decision?**

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**Abstract**

*This paper investigates the relationship between profitability, cost of debt, liquidity, cash conversion cycle, and leverage over time, for companies that mainly operate in wholesale trade of motor vehicle parts and accessories. The bigger a company is, the higher the proportion of bank loans into the total liabilities, and this might be due to banks assessing the larger firms as being more eligible for a loan. Due to the large volumes, they purchase, the bigger companies have also bargain power and can negotiate better payment terms and prices with the trade creditors, which enables them to better manage their cash.*

**Keywords:** capital structure, cost of debt, debt ratio, financing decision, ROA, ROE.

**JEL Classification:** G31.

**1. Introduction**

As long as the cost of debt is one of the multiple factors that have an impact both on the finance structure of the enterprises and the investment decisions (if there are more competing investment project, which one should be undertaken, and the way the potential mix of the funds is used to purchase of various types of assets leading to new asset structure and size), while different investment projects carry different risks thus having an impact on the cost of debt, it is expected that not only these indicators are inter-related, but they also have a direct relationship with the return of equity which shows the efficiency in using the company's own funds.

The literature in this area explains how the cost of debt can impact the financing decision; for example, if, due to factors that do not directly depend on the financial situation of the company, but are rather general economic environment related, the

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cost of debt increases, the company might decide to issue equity if available or even to postpone the investment plans.

At the same time, a company with an already high gearing ratio might not be assessed as eligible for additional loans by the banks, thus having to turn to its shareholders to get its investment projects funded, even if potentially at an increased expected return (as dividends required by the owners); alternatively, the bank might take the risk of lending money to the company but at an increased interest rate and under certain restrictions on using the funds.

Also, the quality and quantity of the company's assets directly impact the revenues that can be generated by them, the inflows that will result in increases in equity and, as such, in the available funds that can be re-invested.

Therefore, the return on equity, the return on assets, and current ratios will be used as control variables to see how they relate to the debt ratio.

## **2. Problem Statement**

During the last few decades, a lot of literature has been produced to address the relationship between the capital structure and firm performance, both theoretically and empirically. Initially, it was F. Modigliani and M. Miller (1958), whose theory demonstrated the irrelevance of capital structure in a company's value. A few years later, in 1963, they revised their own theory and factored the deductibility of interest expense in, leading to the conclusion that the higher the debt ratio is, the higher the company value, too. They were followed by other researchers who found many other variables that influence both the making of decision on the mix of financing resources and the financial performance, which make it very difficult if not impossible to formulate a general theory of optimal capital structure.

Chang (2015), contradicts, through three arguments, the Modigliani and Miller's theory.

Later on, Baker and Wurgler (2002), suggest that companies issue new shares when they perceive that they are overvalued and that firms redeem their own shares when they consider that they are undervalued; this behavior impacts the capital structure, and also the authors Dragotă and Semenescu (2008) sustain that the capital structure depend of the sector of activity of the companies.

Jensen and Meckling (1976), introduced the agent theory, based on different interest of shareholders, managers, and creditors of the company, they identify two types of conflicts: conflict between managers and shareholders, and the conflict between shareholders and creditors. The agent theory proposes the way to reduce the cost by accessing the credit, in this case the creditors are the unpaid and strict monitoring agent. Borrowed capital has a constraint and motivating effect upon managers of the company, they have to be very carefully that company to produce results to can pay the interest and the capital rates, otherwise the company will face the risk of bankruptcy, and the managers lose their jobs (Vernimmen, 2017).

Connelly, Certo, Duane, and Reutzel (2011) declare, that signal theory is based on the different behavior between two parties that have access to the different information, in our case the shareholders and creditors.

In a study based on data from 1.380 European companies for the period 1993-2013, Rauramo (2016) identified that median value of the industry represents an determinant to estimate the capital structure of the companies.

An recent article published in *The Journal of Finance* (2019) signed from the President of American Finance Association, Peter De Marzo, - Presidential Address: Collateral and Commitment – sustain that choosing the optimum capital structure is a problem of engagement. In the context with the agency conflicts between the shareholders and creditors, the complete engagement means that the company will be almost exclusively on borrowed capital.

The Authors Charness and Neugebauer (2019) after a study that test the invariance of the theorem in the market, during the Modigliani and Miller demonstrated mathematically that market value of a company is independent of return on assets economic and the or the equity and debt ratio, if prices are not arbitrage, but the theorem was not sufficient tested on the real markets.

Shemetov (2020) shows that the propositions of Modigliani and Miller are available only short time periods, discrepant with the predication of Modigliani and Miller, structure of assets affects the value of the company.

A more recent study performed by Stanica, Ilie and Taga (2018) on a sample of Romanian listed companies and published identified a positive relationship between the cost of debt of the non-financial companies and the capital structure, while a negative one exists between the cost of debt and the growth opportunities, size, and age of the company; the industry effect was also confirmed as being a factor of influence on the cost of debt.

A study by Botoc and Anton (2017) used the financial information available for the period 2006-2015 for a sample of 937 companies in Central and South Eastern Europe, having a fast economic growth. It showed a U-shaped relationship between the working capital management and the profitability. The optimum of working capital at which the profitability is maximized was calculated at 79% of the turnover. The profitability ratios used in this study were the following: ROA, EBIT, ROIC and WKRC (Working capital ratio = Net current assets / Sales). Working capital ratio carries the contrast between the managers' interest in aggressive commercial policies regarding early payment discounts, and the shareholders' concerns regarding the increase in profitability.

The results of the 2017 study were in contrast to the conclusions of previous research that showed a negative relationship between working capital management and profitability. Ebben and Johnson's findings (2011) are that the US small firms with shorter cash conversion cycles need lower levels of invested capital (long-term debt plus shareholders' equity) and have a positive impact on the financial performance assessed by the asset turnover and return on invested capital and on the levels of liquidity. The study published by Aregbeyen (2013) contributes to the view that the efficiency of working capital should be improved and the cash conversion cycle shortened in order to increase the profitability of the manufacturing firms. Aktas, Croci and Petmezas (2015) argued that there is an optimal level of working capital and that by converging to it, the companies improve their performance.

Another study was conducted in Romania for the manufacturing companies listed on the Bucharest Stock Exchange in 2003-2010. It used a cross-sectional regression that highlighted the relation between the capital structure and the financial performance. The analysis on the capital structure considered: short-term debts vs. long-term debts, total liabilities vs. equity, while the assets performance (ROA) and the equity performance (ROE) are the profitability ratios. The results suggest that for the sample companies, the financial performance is enhanced when they avoid the debts and only use their own financial resources.

Setiyono, and Ernawati (2017) published a study conducted in Indonesia, which included 14 listed companies in Food & Beverage sector and their financial data available for 2013-2015. It outlined that the internal audit and the current ratio do not have any significant impact on the financial performance, while the working capital turnover (Turnover / Net current assets) does.

Going a little farther, in Asia, we find another empirical study that used the Panel data model for IT companies in Bangladesh, listed at the Dhaka Stock Exchange in 2013-2017; the dependent variables selected were ROE, ROA and EPS and the independent variables were debt ratio, equity ratio, long term debt ratio and short-term ratio. Its results show that the capital structure has a significant positive effect on ROA, but ROE and EPS are not influenced much by the capital structure; it also suggests that shareholders' wealth maximization can be done by the perfect mix of equity and debts (Alamgir et al., 2019).

### 3. Research Questions / Aims of the Research

The aim of this paper is to determine the relationship between the debt ratio and the return on equity, the return on assets, current ratios, for the companies that operate in wholesale trade of motor vehicle parts and accessories (NACE Code 4531) and which, at the end of 2020 were still operating in the market.

### 4. Research Methods

The sample analyzed includes the Romanian companies that between 2008 and 2020 had a total annual turnover higher than EUR 100 thousand and operate in wholesale trade of motor vehicle parts and accessories (NACE Code 4531) and which, at the end of 2020 were still operating in the market. They were grouped by the turnover in six categories; in the below table we show the number of companies within each category for every year in our range, as in the Table 1:

**Table 1. Number of companies with > 100 k EUR turnover in 2009-2020**

Turnover	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
1. 100 - 500 k	65	164	156	163	183	202	223	232	250	269	300	314	361	2,882
2. 500 - 1,000	43	84	80	85	82	77	89	105	114	111	101	118	135	1,224
3. 1 - 5 m EUR	97	91	104	111	117	124	119	122	131	141	152	152	137	1,598
4. 5 - 10 m EUR	16	13	17	18	16	16	21	26	31	27	19	23	22	265
5. 10 - 50 m EUR	15	12	12	13	14	11	14	14	14	17	24	22	24	206
6. Over 50 m EUR	1	3	3	3	2	2	2	3	5	6	8	9	11	58
<b>Total</b>	<b>237</b>	<b>367</b>	<b>372</b>	<b>393</b>	<b>414</b>	<b>432</b>	<b>468</b>	<b>502</b>	<b>545</b>	<b>571</b>	<b>604</b>	<b>638</b>	<b>690</b>	<b>6,233</b>

Source: Trade Register Office, data processed by the authors.

When further analyzing the financial data for the companies included in the above categories, we tested the structure of the financing sources where these sources are: suppliers, bank loans, equity, and other debts (shareholders' loans, taxes, salaries, leasing companies). Given that a company cannot afford to accumulate unpaid liabilities to the employees, government, and leasing companies, we can assume that most of the 'Other debts' are actually the money lent by the shareholders of the companies in our sample. The vast majority of these companies are family businesses, and it is not uncommon that the owners provide temporary funds to the firms.

The following four tables (Tables 2-5) show how, depending on their size, the companies in this trading area (NACE Code 4531) make their financing mix up. The financial data processed to get the respective numbers had been extracted out of the annual financial statements filed by the companies with Trade Register Office.

**Table 2. Suppliers share in total financing sources**

Turnover	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
1. 100 - 500 k EUR	0.00%	0.60%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.10%	0.10%
2. 500 - 1,000 k EUR	0.00%	1.40%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
3. 1 - 5 m EUR	0.00%	1.50%	0.40%	0.30%	0.70%	0.50%	0.30%	0.20%	0.20%	0.20%	0.30%	0.10%	0.10%	0.30%
4. 5 - 10 m EUR	7.90%	10.00%	9.80%	12.20%	10.70%	10.10%	9.50%	8.00%	8.00%	9.50%	5.60%	7.10%	7.40%	8.70%
5. 10 - 50 m EUR	26.90%	26.30%	31.10%	31.80%	26.40%	23.60%	20.20%	17.60%	17.30%	21.10%	21.00%	21.40%	17.70%	22.70%
6. Over 50 m EUR	47.20%	43.60%	35.20%	27.20%	25.50%	38.60%	36.70%	49.90%	38.30%	20.60%	21.00%	25.70%	22.90%	29.00%
<b>Total</b>	<b>2.40%</b>	<b>2.50%</b>	<b>1.80%</b>	<b>1.90%</b>	<b>1.60%</b>	<b>1.30%</b>	<b>1.30%</b>	<b>1.30%</b>	<b>1.30%</b>	<b>1.30%</b>	<b>1.40%</b>	<b>1.40%</b>	<b>1.30%</b>	<b>1.50%</b>

Source: Trade Register Office, data processed by the authors.

**Table 3. Bank loan share in total financing sources**

Turnover	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
1. 100 - 500 k EUR	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2. 500 - 1,000 k EUR	0.00%	0.40%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
3. 1 - 5 m EUR	0.00%	0.30%	0.00%	0.00%	0.10%	0.10%	0.00%	0.30%	0.30%	0.30%	0.20%	0.20%	0.20%	0.20%
4. 5 - 10 m EUR	2.20%	3.30%	2.40%	2.60%	3.10%	3.10%	2.70%	1.90%	2.80%	3.40%	4.90%	6.00%	4.60%	3.30%
5. 10 - 50 m EUR	18.80%	18.70%	13.60%	18.20%	19.20%	18.40%	15.50%	14.40%	13.30%	13.60%	12.20%	15.50%	16.40%	15.70%
6. Over 50 m EUR	0.00%	19.30%	18.90%	21.50%	12.90%	29.10%	29.40%	26.30%	21.80%	23.00%	21.60%	16.70%	14.30%	19.50%
<b>Total</b>	<b>1.30%</b>	<b>1.10%</b>	<b>0.70%</b>	<b>0.90%</b>	<b>0.80%</b>	<b>0.70%</b>	<b>0.70%</b>	<b>0.70%</b>	<b>0.80%</b>	<b>0.90%</b>	<b>1.00%</b>	<b>1.00%</b>	<b>1.00%</b>	<b>0.90%</b>

Source: Trade Register Office, data processed by the authors.

**Table 4. Other debts share in total financing sources**

Turnover	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
1. 100 - 500 k EUR	67.30%	60.50%	60.40%	59.70%	59.10%	53.20%	53.60%	50.20%	54.50%	53.40%	48.20%	48.60%	45.70%	53.70%
2. 500 - 1,000 k EUR	66.50%	63.90%	63.00%	61.70%	62.20%	61.30%	59.20%	56.90%	60.50%	58.00%	54.90%	53.40%	51.90%	58.10%
3. 1 - 5 m EUR	60.60%	55.70%	56.20%	55.10%	54.80%	53.20%	53.20%	53.70%	57.10%	55.50%	54.50%	53.50%	49.80%	54.60%
4. 5 - 10 m EUR	45.70%	35.70%	46.10%	36.80%	40.80%	38.20%	42.50%	46.30%	52.20%	46.80%	47.50%	44.10%	42.70%	44.30%
5. 10 - 50 m EUR	17.60%	20.40%	20.90%	13.70%	14.30%	12.90%	19.80%	19.20%	21.00%	21.00%	25.70%	24.40%	21.50%	20.10%
6. Over 50 m EUR	13.70%	9.70%	19.70%	29.00%	48.70%	3.60%	5.00%	6.60%	24.20%	29.70%	27.10%	27.60%	30.30%	24.50%
<b>Total</b>	<b>59.50%</b>	<b>58.20%</b>	<b>58.10%</b>	<b>56.40%</b>	<b>57.00%</b>	<b>55.20%</b>	<b>54.40%</b>	<b>52.80%</b>	<b>56.60%</b>	<b>54.60%</b>	<b>51.90%</b>	<b>50.80%</b>	<b>48.60%</b>	<b>54.20%</b>

Source: Trade Register Office, data processed by the authors.

**Table 5. Equity's share in total financing sources**

Turnover	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
1. 100 - 500 k EUR	32.70%	38.20%	39.60%	40.30%	40.90%	46.80%	46.40%	49.80%	45.50%	46.60%	51.80%	51.40%	54.30%	46.20%
2. 500 - 1,000 k EUR	33.50%	35.20%	37.00%	38.30%	37.80%	38.70%	40.80%	43.10%	39.50%	42.00%	45.10%	46.60%	48.00%	41.80%
3. 1 - 5 m EUR	39.40%	42.40%	43.50%	44.50%	44.50%	46.20%	46.60%	45.80%	42.30%	44.10%	45.10%	46.30%	49.90%	44.90%
4. 5 - 10 m EUR	44.20%	51.00%	41.80%	48.40%	45.50%	48.60%	45.20%	43.80%	37.00%	40.30%	42.00%	42.90%	45.40%	43.60%
5. 10 - 50 m EUR	36.70%	34.60%	34.30%	36.40%	40.10%	45.10%	44.50%	48.90%	48.40%	44.20%	41.10%	38.70%	44.30%	41.50%
6. Over 50 m EUR	39.10%	27.50%	26.30%	22.30%	12.90%	28.70%	28.80%	17.10%	15.70%	26.60%	30.30%	30.00%	32.50%	27.00%
<b>Total</b>	<b>36.70%</b>	<b>38.10%</b>	<b>39.40%</b>	<b>40.80%</b>	<b>40.50%</b>	<b>42.80%</b>	<b>43.60%</b>	<b>45.20%</b>	<b>41.30%</b>	<b>43.20%</b>	<b>45.80%</b>	<b>46.80%</b>	<b>49.20%</b>	<b>43.40%</b>

Source: Trade Register Office, data processed by the authors.

In conclusion, the smaller companies are financed by their owners, either by equity (share capital and retained earnings) or by direct loans (mainly non-interest bearing and generally on an undetermined term), while the bigger a company is, the more balanced the mix between these four sources is, as summarized in the table below:

**Table 6. Summary of the financing mix by categories**

Turnover	Average of Suppliers %	Average of Bank loans %	Average of Other debts %	Average of Equity %	Total liabilities
1. 100 - 500 k EUR	0.10%	0.00%	53.70%	46.20%	53.80%
2. 500 - 1,000 k EUR	0.00%	0.00%	58.10%	41.80%	58.20%
3. 1 - 5 m EUR	0.30%	0.20%	54.60%	44.90%	55.10%
4. 5 - 10 m EUR	8.70%	3.30%	44.30%	43.60%	56.40%
5. 10 - 50 m EUR	22.70%	15.70%	20.10%	41.50%	58.50%
6. Over 50 m EUR	29.00%	19.50%	24.50%	27.00%	73.00%
<b>Total</b>	<b>1.50%</b>	<b>0.90%</b>	<b>54.20%</b>	<b>43.40%</b>	<b>56.60%</b>

Source: Trade Register Office, data processed by the authors.

Because the financial decision seemed to depend on the company size, the relationship between the debt ratio and the financial ratios used for this study (ROA, ROE, and cost of debt) was analyzed for each category. The financial data used to compute the indicators selected as variables were gathered from the annual financial statements filed with the Trade Register Office.

Upon our first attempt to determine how much influence the performance and cost of debt have on the leverage, we noticed that for most of the turnover categories, the influence is rather low, as Table 7 shows, thus leading us to introduce liquidity-related indicators into the model. This influence was measured by the value of R-squared for each data panel:

**Table 7. Influence of ROA, ROE, and cost of debt over debt ratio**

Turnover	R-squared without liquidity ratios
1. 100 - 500 k EUR	9.16%
2. 500 - 1,000 k EUR	13.21%
3. 1 - 5 m EUR	7.04%
4. 5 - 10 m EUR	37.74%
5. 10 - 50 m EUR	23.75%
6. Over 50 m EUR	16.08%
<b>Total sample</b>	<b>8.58%</b>

Source: Trade Register Office, data processed by the authors.

Although we are aware that not always a higher R-squared value means that the selected model fits the data, due to this statistical measure cannot indicate whether the regression model is accurate and that a low R-square value can be determined for a good model (for example, in the case of the models that attempt to predict human behavior; as some previous studies showed, the quality of human resources involved in the business operations and in the financial decision and their level of financial education and sophistication have a direct impact on the performance), we decided to test and see whether adding more financial ratios as independent variables would make any change in the model. These ones are: current and quick ratios, and cash conversion cycle.

The debt ratio was chosen as the dependent variable. It expresses the proportion of company assets that are financed by debt and is used to assess the solvency of a business; lenders and creditors use this indicator to estimate the risk they will incur by extending credit to a company: the higher the ratio, the less likely it is to lend money to it. The formula is as follows:

Total liabilities (short- and long-term) ÷ Total assets

The liabilities contain bank loans, trade creditors, taxes, salaries, shareholders loans, and debts to leasing companies.

Return on equity (ROE) is one of the independent variables. It was calculated as the ratio of net income to shareholders' equity and shows the company's capability to effectively manage the equity investors' funds. A high level of ROE means that a relatively small investment was turned into a big profit, and this is what the shareholders want: maximization of the result of their investment.

Return on assets (ROA) is the second independent variable, which shows the company's efficiency in using its assets to generate revenues. It was calculated by dividing the net income by the total assets in the balance sheet. The higher the ROA is, the more productive and efficient the management is in utilization of the resources the company has available; however, this ratio must be considered in comparison against its competitors in the same industry and sector.

Cost of debt (Kd) is the third independent variable. It is the return that a company provides to its debtholders to compensate them for any risk exposure associated with lending to it. The ratio was calculated by the formula

$$Kd = \frac{\text{Total interest cost incurred}}{\text{Average debt}} * (1 - t)$$

The debt considered here is the total of short and long-term bank loans as disclosed in the financial statements. "t" is the tax rate; for all the years taken into our analysis the applicable corporate tax rate in Romania was 16%. The analysis does not include the structure of the debt by maturities.

Because of the obvious preference for a certain financing mix depending on the company size, the relationship between the variables selected was analyzed separately for each category.

Current ratio (or the working capital ratio) estimates whether a company is able to meet its short-term obligations, thus indicating its financial health; it is calculated by dividing the current assets by the current liabilities.

## 5. Findings

The econometric technique used for this analyst is Panel data regression. In statistics and econometrics, panel data or longitudinal data are multi-dimensional data involving measurements over time (Baltagi, 1995). By combining data in two dimensions, panel data gives more data variation, less collinearity, and more degrees of freedom. Applying the regression equation described below on the data panel in E-Views, we get the following result on which interpretations will be made:

**Table 8. Regression results**

Dependent Variable: DEBT\_RATIO  
 Method: Panel Least Squares  
 Date: 10/23/21 Time: 19:58  
 Sample: 2008 2020  
 Periods included: 13  
 Cross-sections included: 757  
 Total panel (unbalanced) observations: 6233

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROA	-0.525859	0.021871	-24.04329	0.0000
ROE	0.000107	4.19E-05	2.567710	0.0103
KD	1.13E-05	8.92E-06	1.271703	0.2035
C	0.619593	0.003860	160.4965	0.0000
R-squared	0.085777	Mean dependent var		0.566295
Adjusted R-squared	0.085337	S.D. dependent var		0.260426
S.E. of regression	0.249066	Akaike info criterion		0.058443
Sum squared resid	386.4086	Schwarz criterion		0.062767
Log likelihood	-178.1371	Hannan-Quinn criter.		0.059941
F-statistic	194.8124	Durbin-Watson stat		0.211212
Prob(F-statistic)	0.000000			

Source: Trade Register Office, data processed by the authors in E-views.

### Estimation model:

$$DEBT_{RATIO} = \alpha + \beta_1 * ROA + \beta_2 * ROE + \beta_3 * KD$$

$$DEBT\_RATIO = -0.52585934755*ROA + 0.00010749435227*ROE + 1.13474166056e-05*KD + 0.619592549227$$

For example, if ROA increases by 100 bp (basic points), namely 1%, debt ratio decreases by 52 bp (0.52%) and if KD increases by 1%, debt ratio in turn increases by 1.13%. This shows a direct and positive link between debt ratio and ROE and cost of debt, respectively, a negative link between ROA and debt.

Prob: This probability is also known as the p-value or the marginal significance level (Beers, 2022). Given a p-value, you can tell at a glance if you reject or accept the hypothesis that the true coefficient is zero against a two-sided alternative that differs



from zero. For example, if you are performing the test at the 5% significance level, a  $p$ -value lower than 0.05 is taken as evidence to reject the null hypothesis of a zero coefficient. To assess the validity of the model, its prob value is analyzed for each of the variables that make up the model.

R-squared: R-Squared ( $R^2$  or the coefficient of determination) is a statistical measure in a regression model that determines the proportion of variance in the dependent variable that can be explained by the independent variable. Thus, sometimes, a high r-squared can indicate the problems with the regression model. In our case, the value of  $R^2$  (0.08) indicates that only 8% of the variation of debt ratio is explained by the variation of ROA, ROE, and cost of debt.

Prob(F-Statistic): As per the above results, the probability is zero. This implies that, overall, the regression is meaningful.

## **6. Conclusions**

For a company to exist and operate, both its daily business activities and the new investments need to be provided with funds, the two available sources being the company's own money (retained earnings, share capital) and the funds borrowed from third parties, such as banks and other financial institutions, trade creditors, etc. The financing decision, i.e., on maintaining an optimum capital structure to meet the company's financing needs, must consider the risks and the costs associated with raising funds, the cashflows generated by the operations of the business, the level of control (the lenders might impose some restrictions on the operations or on how the available cash is directed toward investment projects, dividend distributions, etc.).

Our study outlines that there is a direct and negative relationship between debt ratio and the return on assets, and this does not depend on the size of the company. Although this might be seen as intuitive, this relationship exists even in the case of the small business whose financing resources are not interest-bearing, suggesting that it is the changes in ROA that lead to the ones in the debt level: a higher profitability of the assets means more self-generated funds and lower needs for extra credit.

A direct relationship between ROE and debt ratio cannot be observed since the coefficients calculated were not consistent across the turnover ranges. Moreover, no link between the cost of debt and leverage could be observed, suggesting that the lenders do not take the level of debt into consideration when assessing the risk of providing funds to the companies in this trade area. Also, it could be that even when interest rates decrease, the demand for borrowing funds to invest in the business remains about the same.

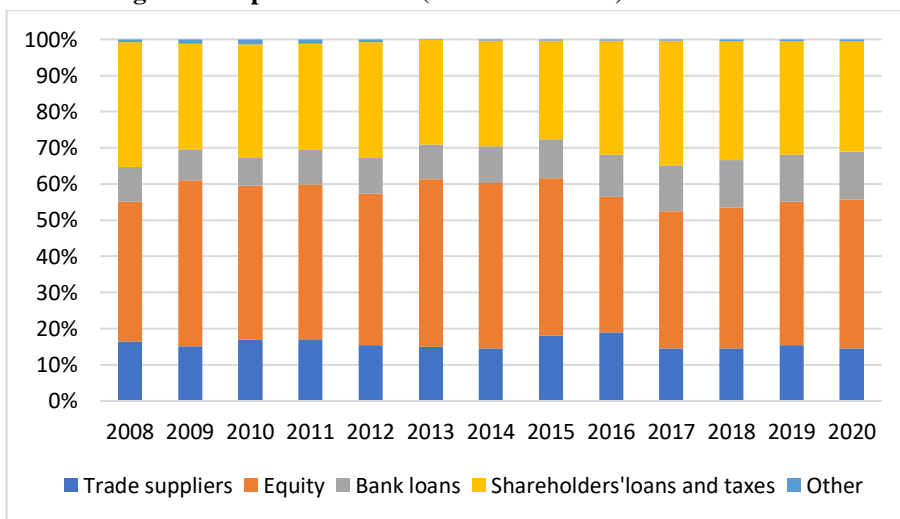
For the small and micro-enterprises (with a turnover lower than 5 million euros), no significant correlation could be observed between the liquidity, cash conversion cycle, and the debt ratio levels. They are funded almost exclusively by the owners and even when the level of liquid assets increases and there is potentially more cash available, it is kept in the accounts instead of being reinvested; the managers in such companies (most of the time they are the owners, too) are less financially educated

and sophisticated, therefore they are less concerned with purchasing and implementing systems to assist in planning and process designing for better managing the components of company's liquidity.

The goal of any business is to maximize assets and minimize costs. In this regard, it is necessary to analyze the weight of each financing option (own funds or debts) in the share of total financing. Debt ratio is an important indicator in corporate financing, being seen as a measure of the degree to which a company finances its operations, this financing assuming debts to fully owned funds. In other words, the indicator measures the level of a company's debts in relation to the value of its net assets. In this paper, we analyzed how cost of debt, return on assets, the financial performance (return on equity), liquidity ratios, and cash conversion cycle relate or not to debt ratio for a sample of 758 Romanian companies in total over a thirteen-year period (some of them active on the market only for a short while), operating in wholesale trade of motor vehicle parts and accessories. None of them is publicly listed.

The overall conclusion is that more financial education is needed both for the potential investors in this sector and the existing ones so that they can make better use of the resources they have at hand and also know where to look up for more sophisticated instruments for funding their businesses. The graphic below (Figure 1) shows the evolution of capital structure for the total sample selected:

**Figure 1. Capital structure (% in total assets) for NACE 4531**



Source: Trade Register Office, data processed by the authors.

It demonstrates that there is a strong preference for the commercial credit over the bank debt, even in the years when the inflation is on a downward slope and interest rates decrease, too, as in this graphic, that discloses the evolution of these values in Romania over the period we studied.

By studying the validity of the model and the connection between the variables, a panel structure was used as an economic technique in the EViews software. Student

and Fisher tests indicate that the model used is valid because the probability of F-statistic analysed for the entire model, respectively, the probability of each t-statistic related to the variables that make up the model, are below the maximum accepted level of 5%, with a confidence level of 95%. An important indicator for the model is R<sup>2</sup>, also called the coefficient of determination. Its value indicates that 55% of the variation of the debt ratio is explained by the variation of ROA, ROE, and cost of debt. The value of the coefficients that make up the model indicates a direct and positive relationship between ROE, cost of debt, and debt ratio, respectively, a direct and negative one between ROA and debt ratio. In conclusion, the initial hypothesis is kept, the chosen model being a valid one, and the dependent variable debt ratio being influenced by the indirect variables that make up the model.

Future analysis should be considering stress scenarios when interest rate should increase, or dividend payment could increase also, because government policy that can approve very low tax on dividend payments.

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