BANK LOANS VS THE BUSINESSES FUNDING THROUGH THE ISSUE OF SECURITIES: EVIDENCE FROM MACEDONIA

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Abstract:

The businesses funding is a complex process because it means financial resources providing, their use, reproduction, return of the borrowed funds to the financial sources, regulation of the economic-financial relation etc. Because of that, the crucial task of the business entities' business and financial policy is the selection of appropriate funding sources that will enable their maximal financial stability.

Self-financing is the cheapest form of financing the reproduction process, which enables high rate of financial independence at making financial decisions, and flexibility in the financial policy running. However, the business entities cannot fund their growth and development only from their own sources. Namely, they often rely on borrowed sources, i.e. on the banks and other financial institutions loans, on the issue of securities, specific forms of funding, and also they use international financing sources.

In the Macedonian economy, due to the complex economic and social conditions, many businesses are faced with the issue of providing quality funding sources. Due to those reasons, the basic aim of this study is to analyze the opportunities for the Macedonian firms to use some funding sources and to identify the problems in selecting the appropriate funding source, which will enable the funding costs reduction, i.e. optimization of the businesses financial structure.

Key words: *funding sources, securities, bank loans*

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Introduction

Financing of businesses is complexity process which involve procurement and utilisation of funds so that business firms will be able to carry out their operations effectively and efficiently.

So, finance is the most important requirement of every business and it is considered as lifeline of the business and crucial determinant on the existing and development of every business.
Inadequate finance poses many problems and may bring an end to the life of the business. The importance of finance has considerably increased in modern days due to following reasons in addition to the usual need:

- Need for Large Scale Operation: Now-a-days business activities are generally undertaken on a large scale. The products of any country are now freely and easily available in other countries. The entire world has become a big market. So to survive in the business world the businessman has to expand the horizon of his activities and function on large scale. This expansion of business always demands more funds.
- Use of Modern Technology: Use of latest technology in the process of production as well as distribution has become imperative for every business now-a-days. To meet the competition, production process now demands use of modern machinery, equipment and tools. Hence, there is a greater need for finance to meet the challenge of the world's markets successfully.
- Promotion of sales: In this era of competition lot of money is to be spent on activities for promoting sales. This involves advertisement, personal selling, use of sales promotional schemes, providing after sales service and free home delivery, etc. which need huge amount of funds.

The business entities can provide the necessary funds for investment projects realization through internal and external sources. Internal funding provides greater autonomy, sovereignty and freedom during the financial decision making. However, quite often, business entities are unable to meet their need for capital only from internal financial sources, and therefore there is a need to acquire capital from external sources. In the developed market economies, the capital market gives an opportunity to economic entities to use different forms of funding. The efficient capital market enables acquiring of the necessary finances through: long-term investment loans, issuance of securities – shares and bonds; as well as use of different derivative financial instruments (Vitanova*et.al*, 2011).

The decision for selecting the financing sources of the business entities' investment projects is one of the most complex activities for the management. Namely, the management's basic aim is to create optimal capital structure which involves minimal financing costs, and at the same time not to lose the ownership control over the company.

Most frequently, the business entities combine various financing sources, taking into the account the relation between the equity capital and the borrowed capital. However, the possibility to make combination of various financing sources is determined by the business entity's life-cycle, its growth phase, the goal and potential of the sector's growth where the particular business entity works, and by its management's attitude towards the risk.

In fact, in the beginning of the business entity's lifespan, it has a low number of available sources for financing its work. By the growth of the business entity, the internal financial possibilities exhaust, while the possibilities for using the external capital in a form of credits from commercial banks, and through securities issue, increase.

In this paper, we analyze the access by Macedonian firms to external financing, both from bank andnon-bank sources. The data in this paper comes from the combination of two differentdatabase,the statements of the National bank of the Republic of North Macedonia and the AnnualStatements of the Macedonian Stock Exchange.

Literature Review

The financing is an important factor that determines the business entities' survival and development. Financing is important for firms because it helps in expansion of operations, innovation, and investing in production facilities and new staff(OECD,2006).At this, the decision whether to use the equity capital or to fund the workthrough a debt is one of the most frequent dilemma the management is faced to.

Namely, there are many researches that analyze the different financing sources advantages and disadvantages, and the factors which determine the decision for selecting the appropriate source.

The traditional view of corporate finance states that debt is generally cheaper than equity as a source of investment finance implying that a firm's average cost of capital becomes lower as it increases its debt relative to equity. Thus, as the firm's average cost of capital reduces with increases in its debt to equity ratio, the corresponding company market value schedule rises and therefore the optimal leverage is determined at the point where the firm's weighted average cost of capital is minimized and the value of the firm is maximized (AlhassanAndani&Seidu Al-hassan,2012).

In contrast to the traditional view, Modigliani and Miller (1958) concluded that capital structure would be irrelevant, implying that the market value of the firm and its cost of capital are independent of its capital structure and as a result there is no optimal capital structure.

The study of Raquel L. G. *et al.* (2007) examines access by Spanish firms to external financing, both from bank and nonbank sources. They're findings reveal that Spanish firms are quite dependent on short term non-bank financing (such as trade credit), which makes up about 65 percent of total firm debt. They also find that short-term bank debt seems to be accessed more during economic expansions, which may suggest a substitution away from non-bank financing as firm conditions improve. Their research shows that the impact of funding costs on access to external financing, whether from banks or non-banks, is affected by the nature of borrowing firms' bank relationships and collateral. Moreover, collateral plays a key role in making long-term finance available to firms.

The research of Spiros B. *et al.* (2006) examines firms' access to bank and market finance when allowance is made for differences in firm-specific characteristics. A theoretical model determines the characteristics such as size, risk and debt that would determine firms' access to bank or market finance; these characteristics can result in greater (or lesser) tightening of credit when interest rates increase. Their research confirms that small, young and risky firms are more significantly affected by tight monetary conditions than large, old and secure firms.

RaanaFarooqi-Lind (2006) investigates the capital structure choices of non-listed firms in Sweden and later compares it to that of listed firms. She finds a number of differences in the capital structure of listed and non-listed firms, as well as differences both in the relationship of debt levels to the explanatory variables employed in most capital structure studies between listed and non-listed firms and in the magnitude of the effect of the variables. This supports the expectation of differences based on listed and non-listed firm differences in the agency costs of debt and equity. Of the most important influences on capital structure, tangibility is common to both listed and non-listed firms. If one makes the assumption that firms with a large proportion of tangible assets in their asset structure are the more mature firms, this would point to the fact that for both listed and non-listed firms, growth options are a major determinant of capital structure choice.

Determinants of Access to External Finance

Corporate sector growth is vital to economic development. One of the main problems of the corporate sector is the access to finance. So, the access to external finance is a key determinant of a firm's ability to develop, operate andexpand (Raquel L. G. *et al.,* 2007).

To understand how firms finance their operations, it isnecessary to examine the determinants of their financing or capital structure decisions.Company financing decisions involve a wide range of policy issues. At the macro level,they have implications for capital market development, interest rate and security pricedetermination, and regulation. At the micro level, such decisions affect capital structure,corporate governance and company development (Green, C.J., *et.al.* 2002).

The practice shows that the most important determinants that affectfinancing decisions are the following:

- Maintaining an optimal balance between the equity and the borrowed (foreign) capital. Namely, these particular relations are basic indicators for the financial power and strength of the business entity, its creditworthiness, rating and business perspective. These parameters, as well as the relations between them, on the other hand, enable us to determine the place and the role of the economic entity on the capital market;
- The degree of indebtedness of the business entity. This indicator has an utmost importance in most cases when deciding on how to provide the needed capital. Namely, if the business entity is considerably indebted or approaches the limit of allowed debt, it does not have a choice, but to provide the necessary capital through issuance of shares;
- The degree of development and independence is also very significant factor that has to be considered. In a situation when the business entity has a successful and stable development, it is logical to decide on mobilization of debt capital, for a simple reason that this will allow it to maintain the high degree of independence and business autonomy in the future as well, which is a very significant prerequisite for maintaining the competitive advantage on the market in sharp economic conditions;
- The degree of risk of the investment capital for which the mobilization of financial resources is made. If the risk of the investment of the potentially mobilized capital is higher, the economic entity will give a priority to the issuance of shares, while on the other hand, if the risk is lower, then it will decide upon debt capital;
- Current conditions on the capital market according to which an equity or debt capital can be acquired;
- The market price of own shares (in case of joint stoke company). If the current, market price of the shares is high and significantly exceeds their nominal value and there is interest for the shares among potential investors, it is realistic to assume that the necessary capital will be obtained through an issuance of shares because they are expected to be attractive on the market;

- The interest rate on the long-term loans granted from the banking institutions. In conditions of low-interest rates and a stable bank loan policy, the economic entities will decide to obtain the necessary funds by taking long-term loans from the banks;
- Tax policy and its instruments have a major impact on the decision to select the source that will provide the necessary funds. In situations when by tax deductions and benefits, bonds are being favoured, it is assumed that the economic entity will obtain the necessary capital by issuance of bonds. In cases when these tax deductions apply to the shares, the economic entity will perform mobilization of capital through issuance of shares.

Given all these factors when choosing one of the capital sources, the business entities should always consider the following:

- If they decide to provide the necessary capital through an issuance of stocks, then the ownership structure of the capital will shift in favour of equity capital; and
- If they decide to provide the necessary capital through an issuance of bonds or by loans, then the ownership structure of the capital will shift in favour of debt capital.

It is necessary to emphasize that there is no universal combination that can be used by all business entities in mobilization of the needed financial resources, and that is why before making a decision they should always make a detailed analysis of all the factors in order to choose the combination that will allow to maximize the value of the entity and minimize the costs for the capital.

External Sources of Financing

The sources of investment finance can be divided into internal and external. Internal sources (retained earnings) are both in theory and practice considered as the most appropriate source of investment finance, but their amount is limited by the profitability of the firm. External debt (loans and issues of securities) is limited by the capacity of the firm to guarantee its obligations, i.e. by the amount of fixed assets that could serve as collateral.

The firm's financing policy therefore requires managers to identify ways of funding new investments so as to generate more wealth and ensure firm sustainability (Abor &Biekpe, 2005).However, the mix of the various funding sources that maximizes the firm's value constitutes the firm's optimal capital structure.

The choice between the equity or debt capital for business needs funding is very complicated process. It is of utmost importance that they resolve certain issues through a detailed analysis, before they decide on how they will provide the necessary capital, whether by loans or by issuance of securities, primarily because the capital secured by an issuance of shares has a proprietary nature, and the capital secured by an issuance of bonds or loans has a debt nature.

The reasons and motives for an economic entity on the capital market to find itself in a role of a user of equity or a debt capital are multiple and varied.A capital market is a financial market where debt and equity securities can be issued and traded. Such markets involve the participation of a wide range of retail and institutional investors, who can invest through pension funds, insurance companies, mutual funds, and other investment routes.

Capital markets play an important role in the overall growth of an economy and help channel savings into productive investments (World Bank, 2017). The role of the capital market to a large extent would ensure the efficient allocation of resources, and this is key for economic growth and development.

Osei (1998) observes that a well-organized capital market is central to the mobilization of both domestic and international capital and that capital has been amajor constraint to economic development for many developing countries.

The amount of new external equity (new funds from the owners) is largely dependent on the legal form of the firm and its ownership structure, on the degree of involvement of the owners into the management of the firm and their willingness to take on new partners, and in the case of public limited companies also on the effectiveness of the stock market (Mikócziová Jana, 2010).

Financing of the business entities through issue of shares brings them many benefits, i.e.:

- This financing source has the lowest pressure on the company, because the mobilized resources can be continuously used, while the dividend pay-off to the shareholders is made by internal decision of the managing bodies;
- The dividend need not be paid-off, while not paid-off dividend can be transformed into dividend shares;
- Increases the company's ability for engaging financial resources from foreign sources (Trajkoska G. *et al.*, 2014)

On the debt side, bonds, debentures and asset-backed securities (ABS) such as collateral debt obligations and mortgage-backed securities, are the most common securities traded in capital markets (Divjot S. *et al.*, 2019).

On the other side, borrowings from banks are an important source of finance to companies. Bank lending is generally considered outside the purview of capital markets, since bank loans are not securitized and tradable, and therefore involve very limited institutional investor participation. Moreover, banks are subject to different regulations compared to capital markets.In the Macedonian context, banks come under the purview of the National Bank of the Republic of North Macedonia while capital market is regulated by Securities Exchange Commission.

The institutional set up of the financial system in the country is a key element of the access to external finance. The financial system in our country is characterized high level of concentration of the banks' capital in the wholeassets of the financial system. This means that about 82.5% of the whole assets of the financial system in Republic of North Macedonia are owned by banks. So, in our country commercial banks are important loan providers.Given their important position, banks remain the most significant factor in maintaining the stability of the overall financial system and other financial institutions. Up to now, in R. North Macedonia, the most important place has been occupied by the credit market, in which the banks have the main role (NBRM, 2018).

CorporateSector Financing in Republic of North Macedonia

Republic of North Macedonia is a small country with registered 72315 active business entities in the in 2018.The data on the structure of active business entities according to the number of persons employed show that the highest share of 79.1% belongs to business entities with 1-9 persons employed, followed by business entities with no persons employed or entities with unascertained number of persons employed (no data on persons employed) with 11.4%, and entities with 10-19 persons employed with 4.3%. The share of entities with 20-49 persons employed was 2.9%, those with 50-249 persons employed participated with 1.9%, while entities with 250 or more persons employed had a share of only 0.3% (State Statistical Office, 2018).

Regarding previous findings, 99.7% of the registered businesses in our country are small and medium sized businesses.

Most businesses in the Republic of North Macedonia are registered as limited liability companies (LLC and Ltd.), while only 500 entities are registered as joint stock companies from which in 2018 only 105 companies are listed on the Macedonian Stock Exchange.

Capacity utilization in the enterprises in recent years has ranged from 52-62%. There are more reasons for such low utilization percentage, but these are noted as most important: financial problems, insufficient domestic demand, slow conquest of foreign markets, competitive imports, and uncertain economic environment.

Furthermore, one of the most serious problems with which the businesses in the Macedonian economy are faced to, is to provide sources for funding their work. This especially refers to the small and medium businesses, which, as it is highlighted above, have the highest (99.7%) participation in the registered business entities in Macedonia and they are the key driver of the Macedonian economy in the view of creating new jobs. The researches concerning their financial problems have shown that the main problem of the small and medium businesses, are the unfavourable loans offered by the commercial banks, i.e. the high interest rates and the complex procedures for the bank credits approval.

Limited access to bank credit, in particular for small enterprises, is viewed by many policy makers and academics as a major growth constraint for emerging and developing economies (Levine R.,2006).

Beside this condition, businesses in the Republic of Macedonia have still most of their investment projects financed with funds provided through expensive bank loans which certainly adversely affects their long-term financial balance and the capital structure. Traditionally, Macedonian companies have mostly relied on bank lending to finance their fixed investment and working capital needs.

In the following paper are shown the gross loans to nonfinancial companies for the period from 2007 up to 2018.

Table 1: Gross loans to nonfinancial companies (in million MKD)

Година	**Gross loans to nonfinancial companies (in million MKD)**	**Percentage share of the Gross loans of nonfinancial companies to GDP**
2007	68,881	18.47%
2008	93,292	22.49%
2009	95,016	22.92%
2010	102,443	23.43%
2011	109,912	23.68%
2012	112,757	24.16%
2013	114,374	22.79%
2014	123,981	23.50%

2015	133,065	23.81%
2016	136,116	22.88%
2017	139,857	22.68%
2018	149,565	22.65%

Source:Indicators on the banking system of the Republic of North Macedonia, Balance Sheets of the Banking System for the period from 2007 to 2018

Although the number of active business entities in the period of analysis (2007-2018) has not been drastically changed, the results of the conducted research have shown that the volume of the bank credits used by the corporative sector has been drastically increased.

In the financing sources structure, the capital and the reserves have the highest percentage and have kept their stabile share (of 52.3%), followed by the loan liabilities, which share has also been stabile (16.8%) (NBRM, 2019).

The indicator of the total indebtedness, as one of the basic indicators of the corporative sector's financial stability, has been decreasing slowly for the second consecutive year and in 2018 it is 47.7% (47.9% in the previous year). Decreasing has also been seen with the indicator of the long-term indebtedness (20.5% in 2017, 19.8% in 2018), while the indicator of "the financial leverage" (debt-to-equity and reserves ratio and total assets-equity and reserves ratio) has remained on a stabile level.

Such positive movements in the segment of the corporative sector indebtedness are a consequence of the improved results in the corporative sector working during 2018, which has had a positive influence on the domestic financial sector stability, having in mind the fact that the corporative sector is an important credit-user from the domestic banks.

Opposite to the funding through the bank credits, providing of the necessary financial resources through issue of securities in the transition countries (including our country as well) has marginal importance, so the advantages of this form of funding are not very well known to the business entities. An additional reason for such a situation is uneconomical mechanism in financing by bank credits, which is a basic method for financing the corporative sector in the transition countries.

However, the developed market economies experience shows that the capital market has a key role in financing the real economic activity, and with that, in supporting the economic growth, as well. Capital market is a very important segment of the financial market, mainly because of that, that in this market the business entities can come to indispensable capital either through credits from banking institutions or through issue of long-dated securities.

Besides that, the capital market enables the risks allocation among the economic agents, and with that it directly contributes to the economic prosperity. At the same time, the functional and efficient capital markets understand existence of low transactional costs, and a possibility for the economic agents to value the financial resources, and therefore, to make investment decisions.

But, the capital market importance for the Macedonian financial system is low, mainly due to the modest securities offering and the low volume of stock market trading by these instruments. The share of the long-term securities issues, and of the classic stock market trading turnover in the GDP, is still on a low level. The issuers' lack of innovation and competitiveness, from the one hand, and the insufficient information and competitiveness of the potential investors in the Macedonian companies on the other hand, also have some influence on the domestic capital market underdevelopment. So, the state is still the most active securities issuer. On the other hand, domestic legal entities are the main long-term investor in the domestic capital market.

In the Republic of Macedonia the capital market is poorly developed despite the existence of a large number of institutions that enable its operation. Namely, the Stock Exchange of securities exists 23 years, was founded in 1996 and today it has 11 members of which 6 banks and5 brokerage houses. It trades shares, bonds and other stock material in accordance with the Commission for Securities.

The basic aim of the Macedonian stock exchangewas to provide effective, transparent and safe functioning of the organized secondary securities market in R. Macedonia, through permanent effort of all investors to provide entrance, i.e. exit of financial instruments for trading in the different stock markets at fair market price, to help trade companies to attract new capital for financing their development and to contribute for building confidence into Macedonian securities market.
Despite the country's businesses having the opportunity to mobilize financial resources available through the issuance of shares or bonds, relatively few of the companies finance its operations through the capital market. Their role as issuers of securities is very rare. The following data are presented for the realized issuance of securities for the period 2007-2018 year.

Table 2: Realized Issues of Long-Term Securities for the period 2007-20018 (in million MKD)

Realized Issues of Long-Term Securities (in million MKD)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Corporate bonds	300	653	0	0	0	0	0	0	0	0	6	0
Shares	1.728	2.728	5.395	3.327	3.531	10.032	121	6.325	117	1.111	249	2.887
Shares issued by banks	1.108	1.275	0	414	3.314	2.546	111	0	0	1.111	249	2.009
Shares Issued by other financial institutions	155	914	226	17	217	191	10	267	0	0	0	0
Shares Issued by nonfinancial institutions	164	539	5.170	2.897	0	7.295	0	6.059	117	0	0	878

Source: Reports of Financial Stability in Republic of Macedonia in the period from 2007 to 2018, National Bank of Republic of Macedonia

The dynamics of the corporative bonds market is especially weak, i.e. since the establishment of the Macedonian stock exchange up today, only three issues have been realized, of which only the last issue has been made through a public offering from a financial institution (NLB bank), which was partially realized with a realization percentage of 88,86%. Such situation in this market segment is a consequence of the fact that the companies have not been interested enough in issuing corporative bonds, and of the lack of sufficient level of banking expertise (in the domain of investment banking) concerning the structuring and promoting this kind of securities. On the side of issuing proprietary securities, the weak interest of non-financial companies in financing their activities through the capital market, is evident. Also, most of the new issues of shares have been made by means of a private offering (Spaseska*et al*. 2019).

Table 3: Percentage share of the issued shares in GDP

Year	Shares issues (in million MKD)	Shares issued by nonfinancial institutions(in million MKD)	Percentage share of the issued shares in GDP	Percentage share of the shares issued by nonfinancial institutions in GDP
2007	1,728	7	0.0046%	0%
2008	2,728	539	0.0066%	0.0013%
2009	5,395	5,170	0.0130%	0.0125%
2010	3,327	2,897	0.0076%	0.0066%
2011	3,531	0	0.0076%	0%
2012	10,032	7,295	0.0215%	0.0156%
2013	121	0	0.0002%	0%
2014	6,325	6,059	0.0120%	0.0115%
2015	117	117	0.0002%	0.0002%
2016	1,111	0	0.2%	0%
2017	249	0	0.04%	0%
2018	2,887	878	0.4%	0.0013%

We have similar situation in the segment of equity securities (shares). The data presented in the previous table show some growth in the shares issuance as an alternative form of financing, in the period from 2007 to 2012, and after that, a drastic decline of the new shares issuances followed, with the exception of 2014 and 2018, when issuances of non-government securities in the amount of 2.887

million MKD were realized, compared to 249 million MKD in 2017. But, by a share of 0.4% in the GDP, the newly-issued equity securities are still of little importance for the domestic financial system.

But, on the other hand, if we look at the shares issuers' structure, it can be seen that the largest part of the newly-issued shares, have been issued by the banks and other financial institutions, i.e. the corporative sector uses in a very low degree the equity securities as an alternative form of financing its investment projects.

Table 4: Comparative analysis of the percentage participation of the issued shares in GDP and percentage participation of the shares issued by nonfinancial institutions in GDP

Percentage share of the gross loans to nonfinancial companies in GDP	Percentage share of the shares issued by nonfinancial companies in GDP
18.47%	0%
22.49%	0.0013%
22.92%	0.0125%
23.43%	0.0066%
23.68%	0%
24.16%	0.0156%
22.79%	0%
23.50%	0.0115%
23.81%	0.0002%
22.88%	0%
22.68%	0%
22.65%	0.0013%

On the basis of the conducted comparative analysis of the credits and the capital market use as a funding source, it can be concluded that the bank credits still have dominant participation in financing the businesses in R. North Macedonia and are the most frequently used funding source, which has been mainly a result of the underdevelopment of the money market and the capital market and generally the low degree of the economic growth.

Conclusions

The financing of the corporative sector's investment projects is a permanent and dynamic process which determines the business entities' survival and development. The business entities most often use a combination of various financing sources, taking care of the ratio between the equity and the borrowed capital. Here, the possibility for using the appropriate financing sources changes depending on the business entity's development stage, i.e. its potential for growth, and on the management's aversion to the risk.

In the current complex economic and social conditions, one of the most serious problems of the business entities in the economy of R. Macedonia is providing appropriate financing sources for their work. The research conducted in this study has shown that the bank credits have dominant participation in the total financing sources, which has been a result mainly to the underdevelopment of the money market and the capital market and generally the low degree of the economic development.

Besides the fact that capital market is one of the important part of financial system, which canenable firms to raise capital by issuing sharesand on that way has become one of the important ingredients of firms' expansion and in turn economic growth, the Macedonian companies very rarely use it for providing necessary financial resources and they limit themselves on getting financial support from the banks, that additionally decreases their low/poor efficiency.

There are many reasonsfor this situation, but one of the most important is thelack of familiarity of the management with the advantages coming of capital mobilization through issue of securities and their fear of losing control over the company in case of issuance of new shares.
Therefore, it is very important to increase the business entities' information on the advantages of the capital market mobilization through long-term securities issue, which will bring increased securities offering in the Macedonian market, and its further development will be animated, as well.

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