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The Comparison of Enterprise Financing Mode and Financial Leverage Analysis

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Abstract: Enterprises need a lot of capital to expand business. Enterprises face many different financing way. Each financing ways have advantages and disadvantages. Enterprises should be combined with the actual situation, choose the appropriate means of financing to maximize their own economic interests. When an Enterprise has strong corporate profitability, debt financing should be selected and more profit can be getting by using of financial leverage. Therefore, the enterprise should arrange the various means of financing, company's liabilities size, duration, structure, solution to the financial leverage and corporate fund-raising effectiveness of financial leverage reasonably to achieve effective optimization.

Keywords: Enterprise Financing; Financial Leverage; Empirical Analysis; regression analysis

1. Introduction

Raise funds is an economic activity that companies take the initiative and actively looking for a certain amount of finance. The decisions of corporate financing directly related to the future effective, survival and development of enterprise. The companies facing funding diversification, the different mode of financing has different the cost and financial risks. It will affect the capital structure of the enterprise and determine the value of the enterprise. it is important to analyze the different means of financing, the cost of financing, leverage, as well as the financing structure.

2. Comparison of enterprise funding modalities in China

2.1. Retained earnings

Retained earnings are retained in the internal accumulation from the previous profits, which comes from the enterprise's production and business activities' net profit including Surplus reserves and retained earnings. The funds raised by fund type are permanent capital, no time constraint and could be used for a long. Retained earnings financing capital is equity capital, which can avoid weakened control of the original shareholders and there is no fixed payment of interest due for repayment on the principal burden. But this way to funding range is small, limited amount of funding by state regulations and the use time of retained earnings is limited.

2.2. Issue shares

Stock refers to the Corporation issued written proof to prove the identity of the shareholders and the interests of the investors and, according to the dividend a transfer. The issue of shares is one of the basic ways of the Corporation to raise its own capital. Different from the rights and obligations of the shareholders, the stock can be divided into ordinary shares and preference shares.

2.2.1. The advantages and disadvantages of issuing ordinary shares

Advantages: the issue of ordinary shares to raise capital with a permanent, with no maturity date and do not need to be returned. No fixed dividend burden to the issue the ordinary shares, pay dividends depending on whether the company earnings and business needs, business fluctuations to bring the financial burden is relatively small, so the funding risk is smaller.

Disadvantages: higher cost in capital of ordinary shares. The dividend should be paid in after-tax profits no tax deductible role, issuance costs of ordinary shares generally higher than other securities. Ordinary shares of the new funding will increase shareholder, which may distract the control of the company. Not issue new shares of the new shareholders to share the company accumulated surplus will reduce the net income per share for ordinary shares, which may lead to a drop in share prices.

2.2.2. The advantages and disadvantages of issuing preference shares

Advantages: no fixed maturity date, and do not have to repay the principal. Most preferred shares with the terms of recovery, which makes use of such funds more resilient. Issued it in weak financial position and withdraw in financial strengthened position which is conducive to combine funding needs, but also be able to control the company's capital structure. Preferred shareholders do not enjoy the right to vote, so the company can avoid the preference shareholders to participate in the voting split out of the control of the company, effectively maintaining ordinary shareholders for control of the company.

Disadvantages: The high cost of financing. Preference shares pay dividends from the net profit after tax, cannot be tax deductible. Therefore, the cost of preferred stock is high and funding constraints, for example, the ordinary shares on the dividend payment restrictions, borrowing constraints. Preference shares pay a fixed dividend, but not in the tax deduction, when the declining profitability, preferred stock dividends may become the company a heavier financial burden, and sometimes had to be postponed to pay, it will affect the company's reputation.

2.3. Absorb investment directly

Absorb investment is a financing method based on the principle of "co-investment, co-operation, a total risk, profit sharing" to absorb the capital of countries, legal entities, individuals.

Advantages: help enhance corporate reputation. The funds rise from investments belonged to its own funds and will enhance the credibility and ability to borrow, which is an important role in the expansion of business scale, the strength of enterprises. It helps to reduce the financial risk. Absorb the investment to pay compensation to investors according to the operating conditions of enterprises, more flexible, so the financial risk is small.

Disadvantages: higher cost of capital, because the remuneration paid to investors is calculated according to the amount of the amount of its contribution and corporate profits. Easy to dispersed corporate control over the absorption of investment to raise funds, investors are generally required to obtain investment suit the quantity of operational control.

2.4. Bank borrowings

The bank borrowing is the payments that enterprises borrow from banks and non-bank financial institutions which are need to repay the principal and interest based on the loan contract. It is the main way for companies to raise capital.

Advantages: fund-raising speed. The way to the bank borrowings is simple. If the loan conditions are meted, no much time is needed, which can meet the company's timely funding needs. The relationship between enterprises and bank lending direct, without going through intermediaries, so the transaction costs is reduced. Fixed costs, interest on borrowings and financial leverage.

Disadvantages: a. Limited funding levels. Banks are usually reluctant to lend huge amounts of long-term loans of loan financing for certain ceiling. b. The LIMITATIONS. Loan contracts signed by enterprises and banks generally have some restrictions on the terms, which may limit the business activities. c. Financial risk. Corporate borrowing long-term borrowings, must regularly debt service, may result in the risk of not being able to pay in the case of unfavorable operating even lead to bankruptcy.

2.5. Commercial credits

Commercial credits are a lending relationship between commodity trading enterprises formed by late payment or advance payment. Commercial credit generated in commodity exchange, which is a form of diversity, applicable to a wide range of short-term financing of the way.

Advantages: Financing for convenience. Business Credit naturally generate with the commodity trading of naturalness financing in advance without formal planning, convenient and flexible. The cost of financing is low with little restrictions. Commercial credits do not have complicated procedures and a variety of additional conditions, nor do they need to mortgage-backed compared to bank borrowings.

Disadvantages: a. The time of funds raising is short. If the enterprises obtain the cash discount, the time will be very short, if give up the cash discount, will have to pay a higher cost of capital. b. There are certain risks. Payer maturity payment owed money for a long time, is bound to affect the company's reputation, resulting future financing difficulties; payee cannot recover the money over a longer period, it will affect the company's liquidity, resulting in the production and management company difficulties.

2.6. Issuance of bonds

The bonds issued by the enterprises in accordance with legal procedures, promise to pay interest periodically at a certain interest rate and maturity repayment of the principal amount of securities, bond holders have a debt obligation of the company claims. Corporation and limited liability companies to issue corporate bonds to raise funds for production and operation, and it belongs to the nature of the liabilities of the fund-raising.

Advantages: lower financing costs. This is because the bond issuance costs is lower than issue stock and bond interest payment before income therefore the actual distribution companies enjoy the preferential income tax deduction. Issue bonds only pay fixed interest to the bondholders. Company earnings do not have the prescribed interest to pay a penny; corporate bond financing benefits will be much higher than its cost of funding. It can ensure the control of the shareholders of the enterprise. Bondholders have no right to interfere in the operation and management of the enterprise, and thus will not weaken the existing shareholders a controlling stake in the enterprise.

Disadvantages: higher financial risk. The bond has fixed maturity and obligations to repay. The limitations are more. Issue bonds are to protect the interests of creditors, which often provide many limitations, resulting in restrictions of corporate finance activities. The amount of funding is limited. Issuance of bond financing, the amount of size is limited, not allowed unlimited expansion.

2.7. Finance lease

A finance lease is a way that the lessee need long-term use of certain assets, but do not have sufficient funds to purchase the asset, then the lesser buy and leased] to the lessee.

Advantages: a. Fund-raising speed. b. With little limitations. c. Eliminated the risk of equipment. d. The financial risk is small. e. The tax burden is light. Rent as a fee can be deducted before tax, with tax credits income utility. f. Maintain a certain amount of credit capacity. In the balance sheet of the lessee, the leased equipment is not in the assets and liabilities of the parties listed in the table; it does not change the company's capital structure.

Disadvantages: a. Higher cost of capital. b. Loss of residual value of assets.

3 The liabilities financing and financial leverage

Many companies are very profitable, no longer need new shares. And the cost of stock issue is high, 2 times higher than the cost of bond issuance in the same scale. The high rate of return required by investors face high risks, higher dividend payment also after tax. Therefore, more and more companies tend to debt financing. Liabilities, it shows that the introduction of financial leverage.

Financial leverage is a process that involves borrowing resources that are paired with existing assets and utilized to bring about a desired outcome to a financial deal. Rational use of financial leverage will give corporate equity capital to generate additional revenue, but may lead to the addition of the financial risk. Financial leverage is usually (liabilities) / (equity).

4. Empirical analysis of company performance and capital structure in the real estate industry

Select 39 listed companies in the real estate industry in 2004 as the study sample. In order to ensure the accuracy and objectivity of the results, excluded the ST companies and all the companies are the A-share listed companies. A variety of factors that can affect the performance of the companies, this article will focus on analyzing the impact of the capital structure of the company performance. Company performance metrics choose to use total assets yield and influencing factors selected asset-liability ratio (divided into two indicators, current liabilities rate and long-term debt rate), net asset size, the main profit growth and total asset turnover rate. Each indicator is defined as follows:

Total assets yields y = net profit / total assets

Current liabilities ratio x1 = current liabilities / total assets

Long-term debt ratio x2 = long-term debt / total assets

Main profit growth x3 = (this year the main business profit - last year the main business profit) / prior year profit from principal operations

Total assets turnover x4 = sales revenue / average total assets

4.1. Preliminary analysis.

The top three total assets yield in the selected sample is the Hengda real estate, Airport Co., Ltd, Yicheng Co., Ltd. Their total assets yields were 7.5676% and 7.0085%, 6.8698%, and current liabilities were 26.1938% 19.9884% 49.8848%. The top three current liabilities ratio companies Rhine home, Shahe Co., Ltd., Beite high-tech are 78.1096% 75.0282% 71.5229% and their total assets yield are1.6721%, 2.7363% and 0.115%, respectively. Lower the yield of its total assets of the company shows that the higher the rate of current liabilities. The top three of the long-term debt ratio, Donghua Real Estate, COSCO Development, Suzhou New-tech are 22.8394% 22.1808% 18.7665% and their total assets yield are 2.7196%, 0.8432%, 2.931%. Long-term liabilities rate of 0 contains 9 listed companies, their total assets yield more than 6% including 3 companies, and between 3% and 6% 2 companies, 4 companies less than 3%. It means that a reverse relationship may exist between the yields of long-term debt ratio to total assets.

The top three of the main profit growth Yicheng Co., Ltd, Shangshi development and Yinji development core profit growth are 169.4395%, 159.2294%, 145.5038% and their total assets yield are 8698%, 2.8819% and 3.6312%. The main profit growth ranked last three Zhangchunjingkai, Lijia Co., Ltd. and Pearl River Industrial are 0.9704%, 0.4662% and 1.8913% respectively. It can be speculated that the higher the growth rate of the main profit the higher the rate of return on total assets. But this relationship is not very clear.

The top three total asset turnovers, Yicheng Co., Ltd., Golden Group, the Hengda real estate are 1.0166, 0.5947 and 0.5412 respectively and their total assets were 6.8698%, 4.6116% and 7.6576%. In the last three total asset turnovers Zhongyuan Development, Zhejiang guangsha, Zhangchun jingkai are 0.1456, 0.1228 and 0.1055, while their total assets yield are 3.2876%, 0.3161%, 0.9704%. This shows that the higher the total asset turnover, the higher total assets.

The top three sizes of the net assets Lujiazui, real estate, Golden Group are 6,022,860,794 yuan, 3451290272 yuan and 2546378029 yuan. Their total assets yields are 5.8138% 5.0047% 4.6116%. The last three ones Tianchuang real estate, seabird development and the Rhine real estate, their net asset size are 247,618,962 yuan, 197,332,258 yuan and 146,374,416 yuan. But their total assets yield rates are 4.2307%, 0.0757% and 1.6721%respectively. It can be speculated that the larger the size of the net assets, the higher the rate of return on total assets.

4.2 Regression analysis

Choose 6 variables: return on total assets, current-debt rate, long term debt rate, Main profit growth, total assets turnover, net assets scale. Use those characters to represent them respectively as below: y, x1, x2, x3, x4, x5. The sample time is from 2000 to 2011. The linear regression analysis results are as follows:

$$y=-2.777-0.05x1-0.015x2+0.001x3+7.729x4+0.286x5 \quad (1)$$
$$(-0.063)(-2.517)(-0.37) \quad (0.139) \quad (4.391)\ (0.824)$$

Table 1. Coefficients(a)

model		unstandardized coefficients		standardized coefficients	t	sig.
		B	std. error	beta		
1	constant	-2.777	7.645		-0.363	0.719
	The natural logarithm of the net assets	0.286	0.347	0.112	0.824	0.416
	Main profit growth	0.001	0.006	0.02	0.139	0.89
	total assets turnover	7.729	1.76	0.607	4.391	0
	current-debt rate	-0.05	0.02	-0.355	-2.517	0.017
	long term debt rate	-0.015	0.039	-0.051	-0.37	0.714

The results Can be found by the regression analysis, the total return on assets has inverse relationship with current liabilities rate, long-term debt rate and Proportional relationship with the main profit growth, total assets turnover, net assets. However, x2, x3, x5 are not passed the T test, so the impact of long-term liabilities rate, the main profit growth and net assets scale on total assets turnover is not very significant.

4.3. Analysis of Results

It can be drawn from the regression results: the higher the profitability of the company, the lower the level of current liabilities, whiles the lower the profitability the higher level of current liabilities. The higher the total asset turnover is, the stronger the profitability of the Company. And the impact of long-term debt rate, the main profit growth rate and the net assets scale on the real estate company's profitability is not obvious. According to the theory, when the company has strong earnings ability, the enterprise should borrow more money to increase the profitability, using the liabilities of the financial leverage effect, on the contrary, should be to reduce debt levels, reduce the level of risk faced by the company.

However, it can be concluded from the sample analysis results, the higher current liabilities rate of the real estate company, the lower total assets yield. The reason for this is determined by the special nature of this industry. Real estate developers in the early need to invest more funds generally cannot be provided by the enterprise's own funds. Most companies are raising funds for liabilities, and liabilities source are the banks. However, in order to prevent their own risk the banks are not possible to lend long-term funding for real estate development and the most are liquidity lending. Real estate companies take advantage of this liquidity as the funds. Every year the companies get loan from the bank liquidity, so the liquidity will play a long-term funding role.

5. Summary

The companies should select the most helpful financing method to enhance the competitiveness of them. The difference of corporate financing and income will have different impact on the improvement of enterprises' competitiveness. Such as equity investments, usually the initial issue of ordinary shares and traded companies will not only bring a huge financial intermediation to companies, but also greatly enhance the visibility and competitiveness of enterprises. Therefore, when making the fund-raising decisions, companies should choose to way to improve the competitiveness. When the company has strong profitability and investment rate of return is greater than the liabilities rate, it is necessary to try to increase the share of debt capital in the total capital, in order to have full access to financial leverage and to avoid excessive proportion of debt capital brought financial risk. So when making the types of financing decisions, financial managers should seek a reasonable balance between financial leverage and financial risk.

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Vitae

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