

## **CORPORATE GOVERNANCE CHOICE REGARDING SMEs FINANCING STRATEGIES IN ROMANIA**

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**ABSTRACT.** The impact of financing strategies upon the financial information (released to users through financial statements) is different in the case of the financial position in comparison with the financial performance. The present study aims to establish, for the Romanian SMEs, which is the main choice of corporate governance as financing strategy. Further, the influence of a series of factors upon the financing strategy is investigated using a multilinear regression model. The study is based on a sample of 1,455 Romanian SMEs for the period 2005-2014. The main finding of the present study indicates that the main choice of corporate governance as financing strategy is the self-financing for 76.50% of the Romanian SMEs. The present study reveals that the variables influencing the corporate governance decisions are: the (business) expertise, the business size, the financial performance according to financial statement, and the main business area of activity. It seems that the legal structure has no influence on the financing decisions. The results of the present paper confirm and extend the findings of other studies in this area with data concerning SMEs in an European developing country.

**Key words:** financing strategy, financial statements, corporate governance, regression model

**JEL classification:** M40, M21, M16

### **1. Introduction and Review of Literature**

The small and medium sized enterprises (SMEs) and the corporate governance represent two major components of today's economy. SMEs account for more than 90% of private sector companies. According to Eurostat, for the

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period 2010-2013, SMEs account for over 99% of the private sector within each member country. Their success or failure has an important influence on the economic growth and on the standard of living. SMEs generate the major part of a country's gross domestic product and provide an important number of jobs. They also have an important contribution to the innovation process.

The access to financial resources for SMEs is quite diverse. These financial resources include: own funding/self-financing (the reinvestment of the net accounting profit), bank loans, and non-banking financial institutions loans, commercial loans, increasing the equity capital through issuing new shares or social parts, different types of leasing, and (recently) crowd funding.

The impact of financing strategies upon the financial information (released to users through financial statements) is different in the case of the financial position in comparison with the financial performance. When the financial position is considered, a financial strategy influences the assets, the equity capital and the liabilities. The assets' entry value might be different depending on the financing strategy; the difference might be important mainly when the cost of debt should be included in the cost of long term assets. The value of equity capital is different when the equity capital is increased through issuing shares or social parts, in comparison with the situation in which the reported net accounting profit is not diminished (by dividend distribution and reinvestment). Furthermore, the liabilities' amount and structure have a different dynamic depending on the chosen financing strategy. In the case of financial performance, the influence of the financing strategy derive from the various costs associated with the respective strategy (mainly the borrowing related costs).

The present study aims to establish which is the main financing strategy chosen by corporate governance for Romanian SMEs between 2005 and 2014. Once the dominant financing strategy is established, a series of factors that might influence the corporate governance choice are determined. The results have supports the initiatives of corporate governance to assess the most adequate financing strategy in correlation with the respective business particularities and, therefore, to be able to take the best financing decision from the cost-profit ration point of view.

To the best of our knowledge, no recent academic study is available on this field for the Romanian SMEs. Thus, we were able to identify only four Romanian academic studies, Dragota et al.(2008, Corduneanu & Milos (2009), Brendea (2014), and Vatavu (2014), related to the financing strategy of Romanian companies listed at Bucharest Stock Exchange.

The present study is unique by taking into consideration a sample of 1,455 at the level of every year for a 10 year period (2005-2014) in order to establish a trend in corporate governance decisions regarding the choice of a financing strategy based on a series of factors.

At international level, the academic literature presents and investigates a series of theories which attempt to determine the factors that might influence the corporate governance choice of financing strategies.

According to Modigliani & Miller (1958), the company value has no influence upon the respective company financing strategy. Later on, the trade-off theory of Myers (2001) suggest that an economic entity will choose the bank loans as long as the savings on profit taxation is equal to the present value of bankruptcy costs.

The (financing sources) pecking order theory of Myers & Majluf (1984) considered that the entities with undervalued equity capital/net assets, due to investors' lack of information, will choose less risky financing alternatives like self-financing and the increase of loans. Therefore, the corporate governance will establish a pecking order of financing sources based on the investors' information level taking into consideration the available financial statements. Other studies for Asian countries (Chen, 2004; Delcoure, 2007) and Great Britain (Watson & Wilson, 2002) establish another priority for the factors influencing the decisions of corporate finance regarding the financing strategy. According to these studies, the first choice is self-financing, followed by the increase of equity capital and only as last resort comes the increase of loans.

Thus, according to Liao (2013), a corporate governance oriented toward performance will use a financing strategy that favors borrowing and will adjust the debt ratio according to shareholders' requirements.

The point of view differ within the market timing theory. According to Baker & Wurgler (2002) and Heyman et al. (2008) the main factors that will influence the choice of increasing the equity capital as financing alternative are: the convergence of shareholders' and managers' interests, a sound/healthy financial position, and an appropriate level of transparency for potential investors. Pnadey (2001) considers that the same factors might, at least, reduce the company's borrowing levels.

The overall economic conditions have also an influence over the choice of a financing strategy (Deesomsak et al., 2004). This general statement is already confirmed by the findings of Fosberg (2012) stating that during economic growth the economic entities will choose mainly to borrow on medium and long term, while during economic contraction will rather choose the short-term loans due to uncertainty (Michaelas et al., 1999).

The company age and the activity sector have a significant impact upon the financing strategy (Xiao, 2011;Johnsenand McMahon, 2005). Even if an economic entity is young and has a low credit rating, according to Levenson & Willard (2000), during the early development stages the companies seems to favor the borrowing. Other studies present conflicting results. Paul et al.(2007)

and Watson & Wilson (2002) show that small new created companies use mainly their equity capital as financing alternative, either through issuing new shares or reinvesting their profit. La Rocca and Cariola (2011), Gregory et al.(2005), Chittenden et al.(1996) consider that mainly the mature business chose to use own funding as financing strategy.

The debt ratio is different depending on the activity sector (Degryse et al., 2012). The transport and utilities companies based their financing strategy mainly on short-term commercial loans and bank overdrafts (Scherr et al., 1993). The entities that function in sectors where the introduction of new technologies has a high frequency, are more inclined to choose as financing strategy the increase of their equity capital (Hogan & Hutson, 2005; Hyytinen & Pajarinen, 2005). The situation is even more sensitive for the high-tech companies. Their development has a higher pace than the irreversible and reversible depreciation (Giudici & Paleari, 2000). Therefore, the classic financing sources are seldom accessed and the debt ratio is very low (Colombo & Grilli, 2007; Freel, 1999). In most cases, the high-tech companies will choose the own financing alternatives and the financing sources available to their owners (Manigart & Struyf, 1997).

The company size is another factor that influences the financing strategy. Thus, according to Lopez-Gracia & Aybar-Arias (2000) it seems that the activity sector is prevalent. Thus, the studies of Lim (2012) and Ahmed (2012) show that the large size entities have the tendency to choose borrowing over own funding.

Asset tangibility influences also the choice of a financing strategy. Daskalakis & Psillaki (2008) found a positive correlation between the debt ratio and asset tangibility. Thus, Nivorozhkin (2005) found a negative correlation between the same two variables especially within the developing countries.

According to Mac et al.(2010) the shareholder structure plays also an important role in ascertaining a financing strategy. The entities controlled by a majority shareholder or a small group of shareholders, mainly if they are family business, have the inclination to favor own financing and a higher degree of independence from financial institutions.

According to Mac et al.(2010) and Sogorb-Mira (2005) a company development prospects are taken into consideration by the corporate governance; if these prospects are numerous, the long and short term borrowing will be favored.

The studies of Berggren et al.(2000), Cressy & Olofsson (1997), and Cressy (1995) suggest that the corporate governance will rather chose external financing alternative if the averssion toward giving up the company control is low.

A series of studies suggest that the financing strategy is influenced by the (majority or controlling) owner's gender. Coleman (2000) shows that in US during 1993 female owners favor the borrowing and will finance their business with a higher interest rate than male owners. Riding & Swift (1990)

showed the women own, in general, smaller and newly launched companies and will use mainly short term loans with low frequency. The study of Haynes & Haynes (1999) indicate the same behavior toward borrowing regardless of the owner's gender.

The research of Brendea (2011), based on Hermanns (2006), breaks the factors influencing the corporate governance decision regarding the financing strategy as follow: institutional factors (the regulations, the bankruptcy procedure, minority investors' protection, and the capital market sophistication), macroeconomic factors (market conditions, inflation rate evolution, loans' interest rates), exogen factors related to the entity (entity's credit rating and market value), entity-specific factors (the level of profit, entity's size, tangible assets, growth opportunities/prospects).

Holmes & Kent (1991) and Lucey et al. (2006) mention another series of factors that have a significant influence on the financing strategy decision; thus, these factors' impact is difficult to assess. Among these factors, Holmes & Kent (1991) mention the trade credit level, the employees' financial expertize and recommendations, while Lucey et al. (2006) mention the past relationships with the financing institutions, the owners' financial standing (if they lent money to the company and their personal collateral which can enhance the company's credit rating).

It is difficult to support any of the above mentioned theories and results; this is mainly due to the fact that the different levels of economic development generate divergent results (Brendea, 2011; Daskalakis and Psillaki, 2008; Hall et al., 2004; Booth et al., 2001).

There are very few (recent) studies on developing countries covering an important number of factors influencing the corporate governance decisions regarding the financing strategies; among these we mention for central and eastern side of Europe Haas & Peeters (2006), Nivorozhkin, (2005) and (2002), Klapper et al. (2002), Cornelli et al. (1996).

## **2. Material and Method**

The source of data for this study covers the past ten years and is provided by the National Council of Private Small and Medium Enterprises in Romania (NCPSMER)<sup>3</sup>, the National Trade Register Office, the Ministry of Public Finance,

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<sup>3</sup> The National Council of Private Small and Medium Enterprises in Romania (NCPSMER) was established in 1992 and is a Romanian confederation, legal person, independent, non-profit, non-governmental and non-political institution. NCPSMER ensures unified representation of the interests of SMEs and SME employers' movement nationally and internationally.

and the Romanian SMEs. An average number of 1,455 SMEs were taken into consideration for the period 2005-2014. The time span of the sample taken into consideration is presented in Table 1.

**Table 1:** The size and time span of SMEs sample used for collecting data

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
SMEs number	1,306	1,178	1,240	1,099	1,485	1,723	1,716	1,858	1,569	1,375

Source: *The National Council of Private Small and Medium Enterprises in Romania (NCPSMER)*

The representativeness of the SMEs' sample was ensured through the following choices:

- the investigated SMEs cover all the sectors, age categories, and the all eight development regions;
- the survey was an optimally-stratified one; the ratio of homogeneous layers (namely the SMEs within the service sector which show similar management and investment features) has been diminished; the ratio of heterogeneous layers has been augmented, by increasing the layer represented by the SMEs in the industrial sector;
- in order to highlight the results by sectors, for each SMEs the main area of activity (which accounts for the major part of revenues) was taken into consideration according to the NACE 2 code<sup>4</sup>; the secondary activities were ignored;
- the microenterprise ratio within our sample is lower than their ratio at country level; this reduction was accepted in order to allow the inclusion of a larger number of small and medium sized enterprises;
- at the level of every year, the SMEs included in the sample varied therefore ensuring a wider diversity of entities included into this study.

Within the first stage of the study, a descriptive analysis was carried on in order to establish which is the main financing strategy for Romanian SMEs. The following alternatives were considered: self-financing, bank loans, leasing, factoring, loans from non-banking financial institutions, and equity capital increase through the issuance of new shares or social parts. The results are presented in Table 2.

<sup>4</sup> The Statistical Classification of Economic Activities in the European Community, commonly referred to as NACE (for the French term "nomenclature statistique des activités économiques dans la Communauté européenne"), is the industry standard classification system used in the European Union. The current version is revision 2 and was established by Regulation (EC) No 1893/2006. It represents the European implementation of the UN classification ISIC, revision 4.

**Table 2:** The descriptive analysis of financing strategies evolution for Romanian SMEs between 2005 and 2014

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Strategy	%	%	%	%	%	%	%	%	%	%
Self-financing	77.72	68.93	71.26	64.42	73.06	69.87	74.90	91.27	91.52	82.04
Bank loans	47.32	56.62	49.52	51.05	35.02	41.39	30.40	25.75	22.43	24.58
Leasing	29.71	38.96	25.88	29.57	19.06	14.61	7.80	2.93	2.36	3.85
Factoring	3.29	0.93	1.93	3.91	0.74	0.80	0.29	0.22	0.06	0.07
Loans from other financial institutions	2.76	0.76	3.82	3.09	1.75	2.50	0.82	1.46	0.51	1.53
Issue of shares/social parts	0.54	0.34	0.40	1.46	1.55	0.11	0.99	0.49	0.06	0.22

Source: The National Council of Private Small and Medium Enterprises in Romania, 2006-2015

The majority of Romanian SMEs choose the financing strategies based on the reinvestment of their net profit, followed by bank loans and leasing.

In order to have a clear confirmation regarding the main financing strategy, Table 3 presents the summary statistics for all the 5 financing alternative considered.

**Table 3:** The summary statistics regarding the corporate governance choice on financing decision for Romanian SMEs between 2005 and 2014

Strategy	Self-financing	Bank loans	Leasing	Factoring	Loans from other fin.instit.	Shares issued
One-Variable Analysis	%	%	%	%	%	%
Average	76.50	38.41	17.47	1.22	1.9	0.62
Standard deviation	9.22	12.41	13.16	1.38	1.10	0.54
Coeff.of variation	12.05	32.31	75.31	112.45	58.06	87.10
Minimum	64.42	22.43	2.36	0.06	0.51	0.06
Maximum	91.52	56.62	38.96	3.91	3.82	1.55
Range	27.10	34.19	36.60	3.85	3.31	1.49
Standard skewness	0.9399	0.0811	0.3256	1.6088	0.5407	1.2435
Standard kurtosis	-0.3272	-1.0843	-0.9109	0.1827	-0.6028	-0.2820
Normal prob. plot (points outside of the straight line)	No	No	No	No	No	No
Trend	Constant	Decreasing	Decreasing	Decreasing	Decreasing	Decreasing

Source: Author's calculations

The average indicated that self-financing is chosen by 76.50% of Romanian SMEs and only 38.41% of the SMEs consider bank loans as a financing alternative. The standard deviation for self-financing seems high in comparison with the standard deviation for leasing, factoring, and equity capital increase. Thus, the coefficient of variation for self-financing is the lowest, indicating a constant choice toward this financing alternative over the past decade. The financing strategy based on factoring had the most unpredictable evolution, exhibiting a coefficient of variation of 112.45%.

For all the cases the skewness and kurtosis indicate that the data are within the range of a normal distribution.

The trend for five of the financing strategies is a descending one. Only self-financing has a constant trend, already confirmed by the lowest coefficient of variation.

Further, the analysis of the factors influencing the corporate governance decision on financing strategy for Romanian SMEs will concentrate on self-financing.

The variables initially selected for the analysis were the following: the age of the entity (less than 5 years, 5 to 10 years, 10 to 15 years, over 15 years); the entity size (micro-enterprises with less than 9 employees, small enterprises with 10 to 49 employees, medium enterprises with 50 to 249 employees); the performance level (as being a general perception of improvement of financial data) reported through the annual financial statements (higher, similar, lower), the legal structure (limited liability or joint stock company), business sector (trade, industry, services, tourism), shareholders/associates level of education (shareholders with higher education studies, shareholders with business studies, shareholders with training abroad), business experience of managers (years), associates/managers age, number of associates, family business or not, the number of hours per day worked for the business by the business owners (more than 8 hours).

Thus, when we collected the data, it became obvious that variables related to the shareholders/associated level of education, business experience of managers, associates/managers age, associates number, family business, the number of hours per day worked in business by the owners were available only for 4 to 7 years. Therefore these variables were excluded. Their exclusion might cast some limitation for the present study.

### **3. Results and Discussions**

Of the initially selected variables, we chose only those that could be followed over the desired time span: the period 2005 to 2014. These variables are: the age of the entity; the entity size; the performance level; the legal form, and the business sector (trade, industry, services, tourism).

Table 4 presents the evolution of Romanian SMEs' age between 2005 and 2014.

**Table 4:** Romanian SMEs' age between 2005 and 2014

SMEs age (expertise)	Mean %	Median %	Standard deviation	Coefficient of variation %	Trend
< 5 years	34.18	35.88	6.42	18.78	↓
5 to 10 years	27.70	26.37	4.49	16.22	↑
10 to 15 years	18.86	16.18	7.30	38.72	↓
> 15 years	19.26	22.17	8.94	46.89	↑

Source: Author's calculations

The new entities are the most numerous, 34.18% and the coefficient of variation is relatively low for this group. Thus, they follow a descending trend indicating a decrease of new entity creation; nevertheless this also indicates an increased survival rate. The least numerous are the entities with an age of over 15 years. This group also registers the highest coefficient of variation indicating a volatile evolution. Thus, the trend of this group is ascending, suggesting that the economic environment support a good survival rate and a business consolidation.

A simple regression was constructed having the SMEs' preferring self-financing strategy as the dependent variable and the age of SMEs as the independent variable. The results are presented in Table 5.

**Table 5:** Self-financing strategy versus SMEs age

SMEs age (years)	p-value	Correlation coefficient (r)	R-squared	R-squared adjusted	Standard error of estimation	Durbin-Watson statistic (P)
< 5 years	0.0027	-0.83	69.61	65.81	5.39	1.9182 (P=0.3077)
5 to 10 years	0.0580	0.62	37.93	30.17	7.70	2.0959 (P=0.4891)
10 to 15 years	0.6940	-0.14	2.04	-10.20	9.68	0.8777 (P=0.0088)
>15 years	0.2484	0.40	16.23	5.75	8.95	0.9900 (P=0.0123)

Source: Author's calculations

The lowest p-value occurs for the newly created SMEs. There is a statistically significant relationship between self-financing SMEs and the SMEs age for the group with less than 5 years (independent variable) at the 95%

confidence level. The correlation coefficient equals -0.83432, indicating a moderately strong negative relationship between self-financing strategy and the newly created Romanian SMEs. This is representative for 65.81% of Romanian SMEs with less than 5 years age. The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level.

The results show that the younger SMEs have a clear preference for self-financing. This finding confirms the study of Paul et al.(2007) for Scotland based on 20 start-up companies and the study of Watson & Wilson (2002) based on 626 British SMEs. Keeping debt related costs at a low level through self-financing seems to be a common feature for the young SMEs regardless if their home country is a developed or a developing economy.

The oldest Romanian SMEs (with an age over 15 years) does not present any significant relationship with the self-financing strategy. This result indicates the Romanian SMEs which manage to consolidate their business do not have a preference toward choosing self-financing as a financing strategy. They might use other strategies, regardless of their costs. This result contradicts the findings of La Rocca & Cariola (2011) considering the Italian SMEs between 1996 and 2005; the study suggest that the mature entities prefer self-financing. The Italian economic environment and the time frame might be the causes of this divergence.

The second variable is the size of Romanian SMEs. Three categories were considered taking into account the number of employees, based on the EU recommendation 2003/361. The evolution of this variable is presented in Table 6.

**Table 6:** Romanian SMEs size between 2005 and 2014

SMEs' size	Mean %	Median %	Standard deviation	Coefficient of variation %	Trend
Micro-enterprises (maximum 9 employees)	69.48	69.02	11.61	16.71	↑
Small businesses (between 10 and 49 employees)	23.11	23.08	7.68	33.23	↓
Medium sized enterprises (between 50 and 249 employees)	7.41	7.95	3.99	53.91	↓

*Source: Author's calculations*

The micro-enterprises are the most numerous and followed an upward trend between 2005-2014. The low coefficient of variation suggests a highly predictable evolution. The least numerous are the medium sized enterprises. They registered a downward trend and exhibit unexpected evolutions from one year to another (coefficient of variation is 53.91%).

A simple regression was constructed having the SMEs' preferring self-financing strategy as the dependent variable and the size of SMEs as the independent variable. The results are presented in Table 7.

**Table 7:** Self-financing strategy versus SMEs size

SMEs' size (employees)	p-value	Correlation coefficient (r)	R-squared	R-squared adjusted	Standard error of estimation	Durbin-Watson statistic
Micro enterprises	0.0081	0.78	60.46	55.52	6.15	1.4706 (P=0.0950)
Small businesses	0.0055	-0.80	63.86	59.35	5.88	1.4277 (P=0.0824)
Medium sized enterprises	0.0175	-0.73	52.68	46.77	6.73	1.5749 (P=0.1331)

Source: Author's calculations

In two cases, of micro-enterprises and small business, statistically significant relationship between self-financing for SMEs and SMEs' size at the 95% confidence level were found. In the case of small enterprises the significance is higher than for micro-enterprises. In both cases over 55% of the choice of self-financing strategy is explained by the size of the SMEs. The correlation coefficients also indicate a strong relationship between variables, thus in the case of small enterprises the correlation is negative. The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level.

The findings show that the smaller the entity, the more likely the corporate governance will choose the self-financing strategy. Once the company is growing in size, the corporate governance will start to consider other alternatives for financing the entity's development. This result is in line with the findings of Lim (2012) for the listed Chinese companies.

The SME performance is the third variable considers within this study. The annual performance was considered and compared with the previous year. Three alternatives were considered: companies that registered higher performances versus the previous year, companies with similar performances and companies with lower performances. The data are presented in Table 8.

**Table 8:** The evolution of Romanian SMEs' performance according to the financial statements during 2005-2014

SMEs' performance according to financial statements	Mean %	Median %	Standard deviation	Coefficient of variation %	Trend
Higher performance	34.21	25.17	17.83	52.13	↓
Similar performance	37.99	34.82	11.84	31.20	↑
Lower performance	27.80	21.97	18.15	62.27	↓

Source: Author's calculations

The results indicate that almost 38% of the SMEs have the capacity to generate similar performances year after year. This group has the lowest coefficient of variation and is the only one exhibiting an upward trend. The group of SMEs with lower performance is the least numerous and registered a descending trend.

A simple regression was constructed having the SMEs' preferring self-financing strategy as the dependent variable and the SMEs' performances as the independent variable. The results are presented in Table 9.

**Table 9:** Self-financing strategy versus SMEs' performance according to the financial statements

SMEs' performance	p-value	Correlation coefficient (r)	R-squared	R-squared adjusted	Standard error of estimation	Durbin-Watson statistic
Higher performance	0.2009	-0.44	19.53	9.47	8.77	0.9792 (P=0.0133)
Similar performance	0.0182	0.72	52.24	46.27	6.76	2.3190 (P=0.5812)
Lower performance	0.9177	-0.04	0.14	-12.34	9.77	0.7922 (P=0.0072)

Source: Author's calculations

Only the group of SMEs that generated similar performances over the years shows a significant relationship between the self-financing strategy and performance. The (similar) performance explains 46.27% of the choice of self-financing strategy. Moreover, the correlation coefficient is strong. The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level.

This result adds a new dimension to the findings of Heyman et al. (2008) regarding 1,132 of Belgian companies between 1996 and 2000; the study shows that the companies with higher financial performance have the tendency to borrow less.

The fourth variable considered was the legal structure of SMEs. Two main alternatives were considered: limited liability companies and joint stock companies.

**Table 10:** The evolution of Romanian SMEs' legal structure between 2005 and 2014

SMEs' legal structure	Mean %	Median %	Standard deviation	Coefficient of variation %	Trend
Joint stock company	3.16	2.72	1.29	40.95	↑
Limited liability company	9.20	90.38	3.10	3.40	→

Source: Author's calculations

The SMEs functioning as joint stock companies are few. The result an oscillating evolution of this form of company and also an upward trend. The dominant legal structure for Romanian SMEs is the limited liability company (LLC). This seems to indicate that LLC is the most appropriate for Romanian SMEs.

A simple regression was constructed having the SMEs' preferring self-financing strategy as the dependent variable and the SMEs' legal structure as the independent variable. The results are presented in Table 11.

**Table 11:** Self-financing strategy versus SMEs legal structure

SMEs' legal structure	p-value	Correlation coefficient (r)	R-squared	R-squared adjusted	Standard error of estimation	Durbin-Watson statistic
Stock company	0.2365	-0.41	16.99	6.61	8.90	1.5042 (P=0.1357)
Limited liability company	0.2981	-0.37	13.40	2.57	9.10	0.9215 (P=0.0225)

Source: Author's calculations

The results show that there is no statistically significant relationship between SMEs preferring self-financing and the legal structure of the company at the 95.0% confidence level. The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level.

Our findings indicate that the legal structure of SMEs does not influence the choice of self-financing as financing strategy.

Companies' sector impact on financing strategy is often analysed and an important number of studies are published on this topic. However, very few studies took into consideration the SMEs in the developing countries. Our fifth variable is this sector of activity. The evolution of these sectors for the Romanian SMEs is presented in Table 12.

**Table 12:** The evolution of Romanian SMEs' sectors between 2005 and 2014

SMEs' sector	Mean %	Median %	Standard deviation	Coefficient of variation %	Trend
<b>Trade</b>	38.40	38.17	3.83	9.98	↓
<b>Industry</b>	19.59	19.78	2.88	14.70	↓
<b>Services</b>	23.25	21.79	6.75	29.02	↑
<b>Tourism</b>	4.7	3.33	2.62	57.45	↑

Source: Author's calculations

The dominant sector for Romanian SMEs during the past decade is trade. The low coefficient of variation indicates a relative stability of these SMEs at annual level. Thus, the number of SMEs in the trade sector seems to be on decrease, similar with the SMEs on the industry sector. The tourism sector concentrate the least number of companies and the data indicate high oscillation in number over the years. The SMEs involved in tourism and services seems to be growing.

A simple regression was constructed having the SMEs' preferring self-financing strategy as the dependent variable and the SMEs' sector as the independent variable. The results are presented in Table 13.

**Table 13:** Self-financing strategy versus SMEs sector

SMEs sector	p-value	Correlation coefficient (r)	R-squared	R-squared adjusted	Standard error of estimation	Durbin-Watson statistic
Trade	0.5385	-0.22	4.91	-6.98	9.53	0.6123 (P=0.0050)
Industry	0.6155	0.18	3.30	-8.79	9.62	0.6803 (P=0.0072)
Services	0.0040	0.82	66.63	62.46	5.65	2.0804 (P=0.4470)
Tourism	0.5239	-0.23	5.26	-6.58	9.52	0.8805 (P=0.0109)

Source: Author's calculations

As the results show, only in the case of SMEs from the service sector a statistically significant relationship could be found ( $p$ -value of 0.0004). The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level. The correlation coefficient is strong for services SMEs sector and services sector explains 62.46% of the choice of self-financing strategy.

This indicate that these SMEs are more inclined to favor self-financing while compared to the other sectors considered. We consider this situation to be relevant given the fact that the percentage of this sector was diminishes when the SMEs sample was constructed. The results for Romanian SMEs in this respect are different from other academic studies. In the cases of Ireland (Hogan & Hutson, 2005), Finland (Hyytinen & Pajarinen, 2005), Italy (Giudici & Paleari, 2000), Belgium (Manigart & Struyf, 1997) and United States (Scherr et al., 1993) for the economic entities within the service sectors (mainly for those involved in transport, utility and hi-tech) the main choice as financing strategy is the increase of equity capital and/or borrowing. The main reason for this difference might be represented by the country's economic development level and the sophistication of its banking system.

As the analyses performed above indicate, of the five variables considered, four showed significant relationships with the self-financing strategy; these four independent variables are: the SMEs' age (less than 5 years), the SMEs size (micro and small entities), the performance (similar performances over the years), and the SMEs' sector (service sector.). The legal structure of SMEs seems to play no role in corporate governance decisions regarding the choice of self-financing as financing strategy.

A multiple regression analysis was performed in order to verify the combined relationship between these four independent variables and self-financing strategy as dependent variable. The results are presented in Table 14.

**Table 14:** Multiple regression results: self-financing strategy versus SMEs' age, size, performance and business sector

<b>p-value</b>	<b>R-squared</b>	<b>R-squared adjusted</b>	<b>Standard error of estimation</b>	<b>Durbin-Watson statistic</b>
<b>0.0231</b>	86.00	74.80	4.63	2.07781(P=0.4163)

Source: Author's calculations

The  $p$ -value of 0.0231 confirms the significant relationship that exists between the variables. The combination of the four independent variables explains 74.80% of the self-financing variability. The Durbin-Watson statistic tests indicates no serial autocorrelation of the residuals at the 95% confidence level.

These results can be used to construct prediction limits for new data. Table 15 presents the multiple regression models that can be used for further investigations.

**Table 15:** The equation of the fitted model of a multiple linear regression describing the relationship between self-financing strategy and the independent variables

SMEs financing strategies	=	-53.82
(self-financing)		+ 2.59*SMEs expertise (<5 years)
		- 1.05*SMEs size (small)
		+ 0.35*SMEs performance (similar)
		+ 2.25*SMEs business area (services)

Source: Author's calculations

#### 4. Conclusions

The results of the present study indicate that the main choice of corporate governance of Romanian SMEs regarding the financing strategy is oriented toward self-financing. Over 75% of the Romanian SMEs chose this financing strategy over the past decade (2005-2014). The evolution suggest a constant trend following a normal distribution over this period. The second choice for Romanian SMEs is represented by bank loans. Over 47% of the investigated SMEs borrow from banks. Within the current study, an entity could access multiple financing sources.

The variables identified to influence the corporate governance decision regarding the financing strategy are: the SMEs' age (less than 5 years), the SMEs size (micro and small entities), the performance (similar performances over the years), and the SMEs' sector (service sector.). The legal structure does not have an influence over the choice of financing strategy.

The Romanian SMEs with and age lower than 5 years are the most numerous within our sample (34.18%). They have a strong negative correlation with the self-financing strategy. These findings are in line with the studies of Paul et al. (2007) and Watson & Wilson (2002) for small entities and start-ups in developed countries.

Romanian SMEs are dominated by micro-enterprises (almost 70%) and small businesses (over 23%). These two groups choose mainly the self-financing strategies. These results are similar with those of Lim (2012) for large entities in emerging economies.

Almost 38% of the Romanian SMEs managed to have similar performances over the past decade, and they exhibit an upward trend. This group of SMEs also show a strong tendency to choose self-financing as main funding strategy. This finding complements the findings of Heyman et al. (2008) pointing to the fact that the entities with good financial performances choose to borrow less.

The service sector, the second most representative within the Romanians SMEs sample, had an upward trend over the past 10 years. This is the only sector of the four considered where the SMEs prefer the self-financing strategy. These findings indicate a different point of view of the service sector SMEs within a developing country in comparison with developed countries where the preference goes toward the increase of the equity capital and/or bank loans, as the studies of Hogan & Hutson (2005), Hyytinen & Pajarinen (2005), Giudici & Paleari (2000), Manigart & Struyf (1997), Scherr et al., (1993) have shown.

The combined influence of the four variables (age, size, performance, and sector) explains almost 75% of the corporate governance decision concerning self-financing strategy variability over the past decade in Romania.

The present study highlighted the fact that within the particular case of Romania, SMEs corporate governance prefers self-financing. Further investigations might relate this preference with SMEs shareholder structure, their understanding of the financing alternatives and with the level of sophistication associated with the capital market and banking sector.

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