**FUNDING SOURCES - STRUCTURE AND VALUES**

**Nadya Marinova – Milanova, Prof[[1]](#footnote-1)**

**Abstract:**

The ratio between own and borrowed capital characterizes the level of financial risk for the company. The interest-related costs are treated differently from tax regulators, it appears that attracting the same amount of funds but from different sources may cost the company differently. The concept of capital value is one of the basics in the theory of capital. It is not limited to calculating the relative magnitude of payments to be made to its owners providing financial resources but also characterizing the level of profitability of the invested capital that the firm must provide in order not to lower its market value . Each of these sources has a different value, but the logic of its formation is the same, and in its most general form it can be described with the well-known model of the balance between supply and demand of financial resources of a given type.

**Key words:** *Finance, financial relations, financial resources, relations*

1. **Introduction**

Financial management distinguishes two main structures - the financial structure and the structure of the company's capital.

The financial structure includes the way to finance the company's business as a whole, ie. The structure of all sources of resources, including short-term. The structure of the company's capital refers to a narrower part of the sources of funds - the long-term liabilities (of own and borrowed capital). The chapter analyzes the structure of capital as a decision-making policy for the company with a long-term nature.

Own and borrowed funds differ in a number of features, the main ones of which are shown in the table.

The capital structure, obviously, has a direct impact on the results of the company's financial and economic activity and indirectly - in terms of owners and creditors, On the magnitude of capital. If the impact on the profit is more or less explicable (some borrowing means reduces the taxable profit), then with the second dependence the things are different. The risk is closely related to yield, ie. with the return on capital employed. Raising the share of borrowed capital (as cheaper) also characterizes the increase in risk for the firm, which is naturally related to the expectation of higher returns. The change in profitability immediately results in a change in the valuation of the respective financial asset (shares, bonds), which also affects the market value of the issuer.

**Table1. Differences between major types of sources of funds**

|  |  |  |
| --- | --- | --- |
| **Indication** | **Fund** | **Loan fund** |
| *Right to participate in governance* | *gives* | *does not give* |
| *Право за получаване на част от печалбата* | *By residual principle* | *Primary* |
| *Right to receive part of the profit* | *Varies* | *Usually predestined* |
| *Term of return* | *Unspecified* | *Established by the treaty* |
| *Comparative Source Value* | *More expensive* | *Cheaper* |
| *Tax benefits* | *there is no* | *There is* |

1. **Main text**

Each business activity is subordinated to three main factors of production - natural resources, labor resources and capital. Their use is related to the costs that the company carries out to attract them. Their significance can be assessed differently depending on the assessment positions - by the state, the company, the owners, etc. from the position of the company, the role of the financial resources is dominant, which determines the responsibilities of the financial manager for their formation, the capabilities and the capabilities for their mobilization. The use of one or another source of financing is related to the periodic costs of the company - payment of dividends, interest, etc. In the overwhelming cases, resource resources are not free of charge, which is why the "value of the source".

The value of the funding source is determined by the amount that should be paid regularly for the resources attracted. (Most often expressed as a percentage). SAs most countries are allowed to include interest on borrowed funds in current expenditure, To reduce taxable profits, and dividends are paid out of net profit after tax, it is clear that the source of "equity" is more expensive than the source of "bank credit". Ideally, working assets are financed at the expense of short-term sources and the main funds are from long-term sources. Payments on attracted long-term funding sources should be made over a prolonged period of time. Thus, from the company's point of view, the essence of the concept of " value of capital" as a level of regular costs for the company is particularly important.

The concepts of "value" and "capital", considered separately, have another, own interpretation. The value (cost) of capital is a rate (interest) reflecting its cost of ownership. As to the choice between the terms "price" and "value", they can also be used as equivalent. For example, the term "value of capital" could be used when it comes to the future of planning. When capital is not attracted. In cases where capital is attracted and costs are known, the use of the concept of "cost of capital" as a characteristic of them is entirely permissible.

Determining the value of capital is not an end in itself, because: first, this indicator characterizes the company's activity in the long run, and secondly, the weighted average value of the company's capital is one of the key indicators in the formation of the capital investment budget.

Each company is usually funded by several sources. Since the value of each source is different, the company's capital value is calculated on the arithmetic weighted average. The indicator is calculated in percentages and, as a rule, by annual data. The main complexity is in calculating the value of the capital received from a specific source. For some sources, this is easy (for example, for bank credit) and for others it is difficult, and accurate calculation is generally not possible. However, even an estimate of the value of the company's capital is useful both for the comparative analysis of the effectiveness of the advances in its activity and for the implementation of its own investment policy.

The financial manager should know the value of the company's capital for a number of reasons:

**• Firstly**, the value of equity represents the return on return on the resources invested by investors and can be used to determine the market valuation of equity and to predict the possible change in the company's stock prices depending on the change in the expected changes Of profits and dividends;

**• Secondly**, the value of the borrowed funds is associated with the interest paid, so the best of the several options for attracting capital should be chosen;

**• Thirdly**, maximizing the market value of a company as a major task for management is achieved under the influence of a number of factors, for example, at the expense of maximizing the value of all sources used;

**• Fourth**, the value of capital is one of the key factors in analyzing investment projects.

For the calculation of the weighted average value of the company's capital, it is necessary to analyze the five major sources of capital:

• *First,* bank credit;

• *Second,* bond loans;

• *third,* share capital in the form of preference shares;

• *Fourth*, share capital in the form of ordinary shares;

• *Fifth*, reinvested earnings (own funds).

Under capital market equilibrium, the value of sources is determined by the interaction of market counterparties. The greater the supply of capital of a given type, the less its price. Demand is opposed to supply, ie. the greater the demand for financial resources of a given type, the greater is its price. The level of capital value is determined by the intersection of these two states at that time. If the economy, for example, is in an inflationary state or plays non-market mechanisms, instruments and constraints, the value of a given source may be distorted (out of market logic).

Each company finances its activities, including investment, from various sources. For the financial resources used, she pays interest, dividends, fees, There are reasonable costs to maintain its economic potential. As mentioned, each source has its value (price) as the relative magnitude (percentage) of the regular cost of providing the given source. It is impossible to give a precise correlation between the meanings of the values ​​of the sources, since in real conditions any deviation, depending on both the external situation and the efficiency of the company itself, is possible.

Nevertheless, the logic and consistency of the procedures for attracting funding sources should be understood and taken into account. Moreover, some ratios, from the theory's point of view, are fully justified. For example, it is obvious that the value of own funds should be greater than the value of the borrowed funds, as the relative costs of maintaining the latter are most often fixed and paid out in advance of dividends, that is, They are less risky, and the lower risk should correspond to a lower yield, numerically coinciding with the value of the source.

Even in a sustainable, balanced economy, the system of financing the company's business is not permanent, especially at the start-up stage. However, in the process of stabilizing the activities, on the scale of production, the relationships with the counterparties, a certain structure of sources is optimized for the given business and the particular firm.

The indicator, which characterizes the relative level of the total amount of the regular costs of maintaining the structure of the capital structure (optimal, target, etc.), advanced in the company's activity, attributed to the total amount of attracted funds and expressed in terms of the annual interest rate , Characterizes the value of the capital advanced in the company's business and is determined as a weighted average cost of capital (WACC). The weighted average reflects the minimum return on the capital employed and the profitability of the company and is calculated using a weighted arithmetic mean. This indicator is approximate, and not only is not achievable, but also unreasonable, since WACC is primarily used to make strategic decisions. For example, this indicator compares the importance of the IRR (Internal Rate of Profit) of the investment project for which the feasibility of the realization is considered.

Concerning the WACC, several clarifications should be made:

First. The meaning of WACC's calculation, as well as the value of any source, is not in the assessment of its meanings, but rather in determining the value of the newly attracted monetary resources, as the main purpose of the WACC is to use as a discounting factor in composing the budget for investment.

Second. WACC's meanings are a relatively stable magnitude and reflect the optimal structure of capital. In this case, the term "optimal" should be understood with some conditionality, as it often has a forced character. The owners and management of the firm may wish to change the structure of the sources, however, by objective and subjective circumstances this is not possible.

Third. There are two approaches to selecting the portions - they are taken on the basis of market assessments of capital components or balance sheet estimates.

Fourth. The accuracy of the WACC estimates depends on how accurately the value of the capital of each source is calculated. In so far as an estimate is used, it is acceptable for analytical purposes. It is only undisputed that under other equal conditions the reduction of WACC helps to increase the value of the company, ie. Of its market value.

Fifth. Formally, long-term funding sources can be identified, their value measured, and the WACC meanings calculated. However, in practice they are most often confined to two generalized sources - own and borrowed capital.

Sixth. The correctness of the WACC estimate implies that the value of some sources should be determined up to and after the tax calculations and how to achieve the desired comparability. The logic of quantitative assessments should be seen from the position of the company's owners, as they (or their managers) make the decisions, including the capital structures that help increase their welfare.

All quantitative assessments should be considered by the top executives of the firm in the context of respecting the interests of the company's owners as the acceptance of any serious financial decision is related to them. That is why the comparability of individual sources is achieved through the use of indicators calculated on a post-tax basis.

When analyzing investment projects, using WACC as a discounting factor is possible if new and existing investments are equally risky and funded by different sources that are typical for financing the investment activity in a particular firm. Often attracting additional sources of funding leads to a change in the financial risk for the company as a whole, To a change in WACC meanings. This factor influences not only the internal conditions in the company's activity but also the external conjuncture of the financial market. Changing interest rates also changes the share of the capital invested by shareholders, which affects WACC.

Not with standing the above-mentioned conventions, the WACC is considered to be the most acceptable benchmark in calculating marginal (marginal) costs of attracting new sources of funding, provided that new projects have the same level of production and financial risk. In addition, WACC can be used to assess the company's market value.

So far, the logic of evaluating the value of the company's capital in the context of the formed financial structure has been tracked. In fact, its assessment in perspective is much more important. For example, to answer the question if the company wants to mobilize funds to realize a large investment project, how much will it cost?

One of the key categories in the economy is marginal costs, which are understood as costs for the next product unit. Their magnitude depends on many factors that can be identified and evaluated using algorithms and models of some degree of complexity. One of the factors that is difficult to assess is professionalism, as a rule, growing with the development of the company and the concomitant increase in production volumes. The relationship between relative labor costs (dependent variable) and production volume in natural units (independent variable) is considered a learning curve. The effect of this curve is closely linked to the Returns on Scale principle when the increase in production volumes is accompanied by a rise in the efficiency of the company's financial and business activity. Research has shown that when doubling the volume of production, relative labor costs are usually reduced at a constant rate of 10-40%.

With increased volumes of production, relative and therefore marginal costs are declining, but this reduction can not be endless. With the accumulation of production and technological expertise and stabilization, the company's activity achieves a certain optimal level of production, and when it increases marginal costs start to increase. One reason is the increase in management costs.

The logic of marginal cost changes also applies to the value of the capital. The weighted average capital value of an existing source structure is an estimate based on historical data. But the value of individual sources, as well as the structure of capital, is constantly changing. Therefore, the weighted average capital value is not a constant value. It changes over time and is under the influence of a number of factors.

Marginal Cost of Capital (MCC) is calculated on the basis of estimated cost estimates that the firm will be forced to make to increase the volume of investments in the form of stock market conditions. The estimated value of the capital, which will be marginal, may differ materially from the current value, ie. of its current stock market price. Consequently, the relative costs of attracting new resources change non-linearly. For example, if the cost of attracting 50 workers is 25 euro per person, then they become 20 euros - if they are like 500 people. It is also the logic and the attraction of financial resources, in which the value of the capital can change in any direction - depending on the volume of the attracted funds. The capital limit may remain constant, however, when reaching a certain critical volume of attracted funds, the structure of sources - WACC is sharply increasing.

It can be assumed that, in a stable company with a funded system of financing, the WACC remains constant, with a certain variation in the volume of resources invested in the investment, and after reaching a certain limit, it increases. Thus, the marginal value of capital becomes a function of the volume of the financial resources involved.

Typically, the logic of the investment process connects the satisfaction of the company's needs to increase production potential at the expense of reinvesting profits, Mobilization of internal sources, leading to asset restructuring. In such cases, the structure of funding sources does not change. However, if the investment opportunities and the company's needs are large, it tries to attract external sources. This leads to changes in the structure of sources, in particular, to an increase in the share of borrowed capital. to increase in financial risk.

It is worth highlighting some important circumstances:

**First**. The analysis of capital cost ratios from different sources shows that long-term loan capital appears to be relatively less expensive than others. Therefore, at first glance it seems strange that obtaining a bank credit can lead to a WACC growth. But the next credit should be considered not in isolation but in the context of the existing conditions, for example, the capital structure of the firm on the day of its receipt, the prospects for profitability in its future business and the associated opportunity for timely repayment of the loan. The bank's lending conditions may differ materially from the 10% or 90% share of borrowing funds in the source structure. Here, the level of financial risk that increases with the growth of the share of borrowed capital is of great importance. Risk augmentation explains the increase in the value of WACC (the weighted average capital value) in this case.

**Second.** WACC has a stable meaning with a certain optimal capital structure, implied as a defined ratio between own and borrowed capital. When reinvesting profits, the share of own funds increases, so the principle of preserving the optimal capital structure gives the firm the opportunity (at least theoretical) to attract a certain amount of financial resources from external sources under acceptable conditions corresponding to the previously formed structure . Thus, the total amount of additional financial resources, the involvement in the investment process of which does not lead to an increase in the weighted average of the capital, is more than the amount of the reinvested earnings.

**Thirdly**, purely theoretically, the marginal value of the capital (MCC) may have several positions of mismatch depending on the degree of resource gradation, how the concept of profit is traded, and what the current system of taxation is. For example, it is theoretically possible to distinguish such sources of funding, such as share capital in the form of preferred and ordinary shares, the postponement of the payment of taxes arising from the differences in the calculation of the profit for the purposes of taxation and the provision to the owners of the company and others.

The company's assessment and, most importantly, the dynamics of this assessment are crucial indicators for the sustainability of its profitable activity and prospects for existence. It is possible to obtain an assessment in different ways, but it is most obvious to use the company balance because the balance sheet provides a generalized financial model for the company. The problem is that it is usually compiled at so-called historical prices, and therefore does not give, does not show the magnitude of the market value of the firm. The balance can also be compiled in market assessments, but this is usually done on a liquidation balance when liquidating assets at current market prices. Therefore, the value of the firm in market and balance sheet estimates, as a rule, is significantly different.

The main property of the balance is that the assets and liabilities, as well as their changes, are equivalent. A certain complexity in their interpretation occurs only in the case of the presentation of the balance in market valuation. There are no particular problems when the starting point of the analysis is the market valuation of the assets. If this estimate exceeds the carrying amount (or less), the difference can be traded as a notional profit (or loss). This difference increases (decreases) equity, ie. is included in the balance sheet liability. Interpretation is more complex when it comes to the market valuation of liabilities, which is a purely analytical operation on capital markets. In this case, the difference between market valuations of assets and liabilities characterizes the gudilla (positive or negative). Its economic meaning is based on the value assessment of what the company has achieved at the time of its non-material valuations (trademark, patents - developed and not shown, collective status, etc.). With equal other conditions, the greater the value of the positive hood, the more valuable the company is.

There are three key features in analyzing its value in market valuations - value, market capitalization and aggregate market value.

Value of Firm is the magnitude of its own capital (ie the owners' capital). In this case, the company is considered as a normal commodity sold on the market. On the stock market there is the endorsement - "buy no shares, buy business". There is a slight connotation here about the role and importance of the Gouduilla. The value of the company at market prices is revealed by two situations: first, as a mere firm that even has a relation to the stock market, it is only as a participant in the secondary market; Secondly, as a company that quotes its shares on the organized stock market, that is a listing company (Listed Company).

In the former case, the notion of market prices with a certain conditionality is applicable only to the assets of the firm. Some market value of such a company may be obtained by estimating its net assets under fictitious liquidation and using market valuations of assets in the company's balance sheet. This conditionality is related to the fact:

*• firstly*, that market prices do not exist for all assets, so it is necessary to resort to the sufficiently subjective concept of "fair value";

*• second*, that the value assessment obtained has a local, individualized character, as it expresses the opinion of a particular valuer rather than the market as a whole;

*Thirdly*, that the true significance of the market value of non-life firms can only be determined as a result of a sale-purchase transaction, and therefore all estimates of its value obtained indirectly are sufficiently contingent.

In the second case, for a company listing its shares on the stock exchange, the valuation of its value is formed on the market and is expressed through the current market prices of the shares in real time. For the listing companies, the term "market capitalization" is used as a collective estimate of the economic value of all company shares admitted to trading on the stock exchange (the terms "market capitalization" and "value of the listing company" are synonymous).

The term "value of the firm" should not be confused with the valuation (accounting or market) of the firm's assets. In the first case, the capital (ie part of the balance sheet liability) or net assets and the intra-company asset, and in the second the balance sheet asset. From a formal point of view, the value of the company summarizes the value assessment of three components:

• First, the company's net assets remaining at the disposal of its owners after satisfying the needs of third parties (assessment of the possible realization of the assets separately);

• Secondly, the company's profit as a set of intangible intra-company factors, providing the company with additional competitive advantages;

• Thirdly, the market expectations regarding the company's prospects (this applies only to the listing companies).

At the core of the first component are the assets of the company, the second - the inherent management and technology culture, relations and reputation, the third - the relatively sustainable or the agitatorial expectations of investors regarding the investment and speculative attractiveness of the securities as commodities on the stock exchange. The largest component of the company's market capitalization is the last component. But a strict separation is virtually impossible, since any solution to such a division is extremely subjective.

The identification of the term "value of the firm" and the determination of its value is sufficiently ambiguous. If the company is viewed as a commodity, then the aforementioned treatment for the value of the company is true. The legal aspects are also well suited to this concept. In the absence of complicating the situation external factors (forcing the liquidation of the company) it is the owners of the company can decide its destiny.

1. **Conclusion**

However, there is another class of investors - creditors who also finance the firm on a long-term basis, and therefore, if it is based on the nature and regularities of the stock market as a whole, the value (value) of the firm can be characterized as a collective valuation of the shareholder and the bond capital. Thus, the aggregate market value of the firm (Total Market Value of the Firm) represents the total market value of the shares and bonds issued by it and traded on the stock market. This is the value assessment of the firm from the positions of all the capital suppliers (investors).

It is worth stressing that the value and structural assessments of the company's share and bond capital are interrelated. For example, raising the level of financial leverage (the ratio of borrowing to equity) leads to an increase in the risk to equity holders, who in that case also expect growth in yield (primarily capitalized), which influences the market price of the shares.

The valuation of the value of the business is an extremely important component of the business services provided in the market economy. There are three basic approaches to this end:

• *market -* apply to non-litigious companies by analogy with listing companies;

• *profitable -* by discounting the expected future income;

• *cost or property* – b y assessing the assets and liabilities of the company with subsequent calculation of the net assets.

In conclusion, the following summaries can be made:

First. Any professional reflection on the value of the firm implies a clear understanding of the economic and legal nature of the concept in which it operates. The company should be assessed differently depending on it.

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1. New Bulgarian University, Address: 21 Montevideo Sofia, Bulgaria, e- mail: nmarinova@nbu.bg [↑](#footnote-ref-1)