

IMPACT OF THE FINANCIAL STRATEGY AND THE CAPITAL STRUCTURE ON THE FINANCIAL PERFORMANCE AND COMPETITIVENESS OF SMES

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The present study primarily focuses on establishing the literary foundations serving as a basis for a future research project on the topic. The article deals with the most important financial factors of competitive corporate operations by examining Hungarian and international literature. The major aim is to identify those financial factors that directly influence efficient financial operations. Based on our preliminary secondary research, corporate capital structure, financial strategy and the elements of the inside and outside the company culture are considered as such factors. Indirectly, as a soft factor, the issue of trust is also included here; since trust is a major expectation from both inside and outside the company stakeholders. Our professional opinion is that today's digital transformation will fundamentally change company management, and both present and future leaders need to adapt to these changes. As we see it, highlighting the financial components identified in our article can be regarded as a specific competitiveness factor.

Keywords: SME, competitiveness, corporate financial strategy, capital structure

ABSTRACT

Jelen tanulmányunkban alapvetően a téma szakirodalmi megalapozottságára fókuszálunk, amellyel szeretnénk meg-alapozni a jövőbeni, fenti témával foglalkozó kutatásainkat. Cikkünk hazai és nemzetközi irodalmak feldolgozásával a versenyképes vállalati működés legfontosabb pénzügyi faktoraival foglalkozik. Elsődleges célunk, hogy azonosítsuk azokat a pénzügyi faktorokat, amelyek közvetlenül, illetve közvetve képesek befolyásolni az eredményes működést. Előzetes kutatásaink alapján ilyen közvetlen tényezőknek tekintjük a vállalatok tőkeszerkezetét, pénzügyi stratégiáját, valamint a vállalaton belüli és kívüli pénzügyi kultúra elemeit. Közvetetten, puha tényezőként ide soroljuk továbbá a bizalom kérdéskörét, amely a vállalaton belüli és kívüli stakeholderekkel szemben fogalmazódik meg fontos elvárásként. Meg-látásunk szerint a tanulmányunkban azonosított pénzügyi részterületek fókuszba helyezése különös versenyképességi tényezőként is felfoghatóak.

Kulcsszavak: KKV, versenyképesség, vállalati pénzügyi stratégia, tőkeszerkezet

INTRODUCTION

In maintaining and improving competitiveness, besides leadership, organisational and productive efficiency and appropriate cost management, high level financial culture and financial awareness have become more and more important factors. To achieve the set goals, it is not enough to focus on the technical and technological conditions of production; financial decisions also have a decisive effect on corporate effectiveness and competitiveness. However, it has to be emphasised that they need to be dealt with on strategic level to best serve the purposes of corporate effectiveness.

Alongside a general comprehensive overview of strategic management this study aims at identifying those financial factors – which can be interpreted as specific competitiveness factors – that directly or indirectly influence the effective operation of companies.

FINANCIAL CULTURE – STRATEGY- AND CONTROLLING-FOCUSED APPROACHES

The **basic role of strategy** is to enable a company to implement actions that help them **create a greater value for consumers than competitors** in the chosen target markets (Chikán 2013; Dietmar–Schäfer 2015). The fundamental aim of businesses is value creation, which, according to Chikán (2013) has to have double focus: besides creating value for consumers it has to do the same for the owners. **Company vision and strategy play a vital role** in achieving core goals since they determine long-term goals. A company **lacking a strategy is lacking conscious and predictable control over its future** (Malik 2013; Reszegi–Juhász 2014), and control is becoming increasingly important these days. In his book Sinkovics (2010) draws attention to the fact that with the dramatic decrease of natural resources, economic operators, that is governments, businesses and households will

face a brand new situation in the forthcoming decades of the 21st century, which requires the development of appropriate strategies and planning methods both in the public and business sectors. George Friedman (2012), the founder and CEO of Stratfor, in his book, highlights **technological and demographic imbalances**, which also have a significant effect on the business strategies of the coming decades. Virág and his co-authors (2013) say that “in the lack of a well-thought-out strategy, arbitrary product development, that is a far cry from market realities, technical and technological development disconnected from industrial conditions, primarily prestige-focused brand management and self-serving, occasionally fashionable trend-driven organisational development which is not matched by a change in the scope of activities, is not uncommon”. **The series of unfounded decisions usually generates extra costs in turn**, and they divert attention from economic decisions bearing real significance; thus, leaders cannot properly attend to rapid market changes. Therefore, the management should apply organisational and management methods that improve business flexibility, responsiveness so that they are capable of reacting efficiently to unanticipated and unexpected environmental challenges. (Kozma 2018; Budavári et al. 2017) This simultaneously means that a company can never be a totally closed system. An economic operator and its strategies have to be open to changes (Csath 2010) with a view to being able to carry out reorientation or change (Csath 2010) if – despite careful analysis – unexpected situations surface in their environment. Only companies that are open in their organisation, operations and management can retain their competitive position, and improve their performance amid today’s more and more surprising environmental challenges (Hoványi 1999).

The outside environment puts a heavy pressure on businesses. With the changes of

environment come not only new opportunities but also dangers to the company's strategy development. Alongside that of the outside environment, an analysis of companies' internal conditionality is also needed since a business's strategic conditions are determined by its resources, employee qualifications and skills, as well as sufficient resources and abilities for responding to changes (Thomson–Strickland 1992). To be able to retain a company's competitiveness in the long run, information is necessary about the environment, the market, competitors and consumers, just as the accurate assessment of a company's own position is essential (Hágen 2008). These pieces of information can be acquired from the business's micro and macro environment. Continuous strategic operation includes gathering and analysing information, pinpointing directions for development, as well as executing and implementing a strategy.

In the globalised and rapidly changing world economy of the 21st century, businesses leave greater and greater room to the **application of those management systems** that primarily contain **financial decision-supporting information**, thereby aiding both the operative and strategic levels of management (Zéman 2016). In developing an economic operator's future vision, its target system and task structure, top management fundamentally relies on the consistency of financial and financing perspectives to ensure the sustainability of operational processes (Horváth 2016). A major present and future challenge with respect to corporate and economic sustainability is how to attain **dynamic corporate governance and competitive business management** in a way that it **can adapt to outside environmental conditions in the most effective way possible**. In today's globalised world excellent management, appropriate organisational structure and culture, employment of a qualified workforce, cost-effective management, improving the quality of production and the company's ability to adapt and react rapidly, are of vital

importance. In possession of these **businesses** have an opportunity to **improve their competitiveness**. To achieve and sustain competitiveness, an important connection has to be taken into account: one of the basic preconditions for a company's ensuring expected efficiency is to carry out their business activities in an economically well-founded way. The levers of corporate development are the sound management of financial resources, and the development and implementation of appropriate investment and capital expenditure policies. Entrepreneurship in a changing environment entails substantial risks; therefore, risks need to be identified and neutralised in time. This involves management measures which play a vital role in the long-term sustainable development of businesses (Stefan, 2014). According to Sun (1988) the lasting success of a company requires two basic factors: (1) the knowledge of its own skills and abilities, and (2) the constant identification of the company's environment. This means that there is a heavy emphasis on the continuous analysis of the company (strengths and weaknesses) and its outside environment (opportunities and threats), which together determine corporate performance (Heinz et al. 2013).

Growing competition and the expansion of activities make corporate governance more and more complex, and parallelly, the **role of the decision-supporting function has acquired a new significance**. Leaders have a strong interest in its success as decision-making is based on information available to them (Horváth 2011; Göröcsi 2017). The **active use of different market-related information contributes to the efficiency of companies' product development** and also to the **overall corporate performance** (Moenaert–Souder 1990; Moorman 1995).

According to Horváth (2009) controlling – from a functional point of view – is a sub-system of management which coordinates planning, checking and information supply.

Its general function is planning, the **comprehensive systematic surveillance of business activity**, periodic evaluation, information supply and thus the management of activities to achieve strategic goals and help adapt to environmental conditions (Hahn–Hungenberg 2001). The **primary aim of controlling** is **providing the management** accurate, **reliable and timely information** about the position and ongoing operation of the company. This means providing short-term operational information for operational management and comprehensive information to serve as a basis for strategic decisions.

In **improving business effectiveness and efficiency the respective management**, therefore directing, organising and controlling functions as well, **play a dominant role**. This is justified by a 2012 multi-country research project in which Bloom, Sadun and Reenen (2012) studied the role management plays in business performance. According to the results three factors have a decisive role: (1) the quality of short- and long-term goals and task definitions which extends to productivity, (2) the system of performance assessment related to rewards and wages and (3) the refined, differentiated and continuously analysed performance assessment and controlling system. It was also investigated whether businesses with excellent management are more successful than businesses having not so good managers. The study revealed that the majority of companies have poor management, while companies having a quality management perform better in every respect, and it is reflected in smoother business growth. The foundations of the theory on business growth were laid in 1959 by Penrose, who looked at companies as a system of productive resources. In her work Penrose presented firms which operate in an imbalanced environment under uncertain conditions, yet they are able to adapt flexibly. According to Penrose, the **organizational learning process has a crucial role**. **She believes that** company management gets

more and more efficient over time as daily tasks become a routine, freeing management input which enables managers to concentrate on value-creating growth opportunities (Katits–Zsupanekné 2017).

One of the greatest challenges of modern strategic management revolves around the question of building and maintaining a lasting competitive advantage for companies. Thus, strategic resources are born out of organisational learning and knowledge, which means that a company's past plays an important role in their formation (referring back to Penrose's thoughts).

FINANCIAL STRATEGY

One of the most decisive areas of corporate strategy is financial strategy, which area defines the company's overall financial objectives and operational framework and is dealt with and coordinated at the top company level. A central question of corporate strategy is how to create value for owners (Czakó–Reszegi 2010), and financial strategy plays a vital role in value creation. It is generally accepted that the basic task of financial strategy is to ensure the financing of corporate operations, as well as to use and invest available financial resources in an effective way (Zéman–Tóth 2017). Besides increasing the value of the company, one the most dominant tasks of financial management is financial strategy development. Based on this, Chikán (2013) divides a financial leader's tasks into two areas: firstly, obtaining funds for efficient operations, secondly, the efficient distribution of funds among investment options which serve the implementation of the strategy. Management needs to make decisions constantly related to these two areas based on the analysis of the inside and outside environment. Decisions made by the financial management influence every functional area and have an effect on the business's survival, functionality and even business results.

FINANCIAL CULTURE

However, for the appropriate operation of the above processes, the financial system of a company, high level of financial awareness and financial culture are required. The present study does not address financial culture theory, instead, it focuses on its practical application. Financial culture has two distinctive areas: internal and external elements. When looking at internal financial culture, the focal question is how well-founded corporate financial decisions (both in terms of investment and financing) are; what investment strategy, capital structure, financial controls and analysis are used; how well-developed the frameworks for the internal controlling system are; what the basic principles of controlling activities are; and its regularity is also an important factor. As can be seen above, several areas which have an effect on corporate performance and efficiency need to be addressed. Of course, the significance of external culture must also be stressed; its basic components are as follows:

- monitoring inflation and central bank base rate;
- detailed analysis and market comparison of credit structures;
- continuous analysis of world market processes and integration of likely impacts on company operations;
- monitoring economic policy decisions and translating them for the corporate level.

The two above approaches (internal and external) combined constitute the overall financial culture of companies. When both internal and external processes are of high standard, it can be said that companies are able to perform much more effectively.

CORPORATE FINANCING AND CAPITAL STRUCTURE

One of the most essential questions of corporate financing, the supply of funds is the **development of the capital structure** serving operations in the most effective way possible. This is justified by a 2016 international survey which showed that company leaders find the assessment of capital structure and investment exceedingly important in making strategic level decisions, in practice as well (Zéman–Tóth 2017). Research on optimal capital structure concluded that marginal costs of funds play a crucial role in increasing the dividend payable and company value, which is in the direct or indirect interest of not only owners but also other internal and external stakeholders, since it can mean a certain guarantee for their payment claims (Sisa 2009). In the light of the above and the fact that not only loan capital but also own capital entail costs, and the different capital elements mean differing costs for companies, as well as unused capital funds invested elsewhere can be profitable (Bélyácz 2013), it can be stated that by taking into account risk – yield – liquidity relations, financial leaders must aim to develop a capital structure which contributes the most to increasing business value, efficiency, profitability and competitiveness.

TRUST

Today trust as one of the most important critical success factors is a decisive element of ensuring competitiveness. When the level of trust is increased in a community, corporate competitiveness increases as well (Chikán et al. 2006). Moreover, it can be claimed that corporate decisions based on trust may bring up to 15–20% cost savings for businesses (Allée 2005), therefore, trust has a significant financial effect. It is also discussed in the book *Trust* by Fukuyama (2007), who projects the relationship between trust and efficiency to corporate cost management as follows: “For example, certain societies whose economic operators trust one another can save a lot on transaction

costs and become more efficient than societies with a low level of trust which need detailed contracts and enforcement mechanisms” (pp. 488–489.). At the same time trust is not only important in terms of external economic events, but also plays a major role in internal organisational culture and human resource efficiency; by increasing trust internal operations also become more efficient (Chikán et al. 2006).

SUMMARY

The present study, beyond a general review of strategic management, aimed at identifying those financial factors with a practical

approach which may contribute significantly to the efficient operation of businesses, as well as to retaining and improving their competitive position. We presented the function of financial strategy, summarised the different internal and external elements of financial structure; moreover, we emphasised the importance of optimal capital structure efficiency, effectiveness and its impact on the value of the company, as well as the significance of trust as a decisive factor in competitiveness.

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