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Patterns of corporate financial positions

4.1 Introduction

This chapter investigates empirically the behaviour of the distribution of corporate financial positions in Hungary in the transition period, focusing on indicators of leverage, liquidity, profitability and efficiency. We analyse company accounts data for an unbalanced panel of about 18,000 Hungarian non-financial firms between 1989 and 1999. This data set allows to characterise the static and dynamic features of the distribution of financial positions for a large cross section of firms and to assess the impact of the transition process on the financial stability of the Hungarian corporate sector.

At the beginning of the transition process there was widespread concern that the shift to a market economy could lead to serious problems for the financial and corporate sector. The working of the financial system under the planned system was so different in terms of objectives and instruments, that many feared that both the supply and the demand side of the credit market would not survive the changes entailed by the transition process.[1] It is therefore particularly important to assess the effects of the transition process on the financial structure and performance of firms.

Three main questions will be addressed. First, we examine the static pattern of corporate financial structures in the 1990s, assessing the extent to which Hungarian firms rely on internal as opposed to external finance, debt or equity, short-term or long-term debt, loans or other types of debt. We also investigate the pattern of indicators of performance (profitability and efficiency), and their relationship with financial structure. Second, we analyse whether there are significant differences in financing patterns among various classes of firms. In particular, we focus on disaggregations by ownership (state-owned, private domestic, foreign), size (small, medium, large) and industry (Agriculture, Construction, Manufacturing, Utilities, Trade). Third, we study

[1] See e.g. Colombo and Driffill (2003), Stephan (1999), Halpern and Wyplosz (1998).

how the distribution of corporate financial positions evolved over time, examining both external shape dynamics and intra-distribution mobility.

We find that in the 1990s Hungarian firms made relatively little use of external debt, and that a large fraction of them did not use bank credit, while making extensive use of commercial credit. The results also indicate that Hungarian firms made little use of long-term debt to finance their assets and, as a consequence, were highly vulnerable to shocks affecting their financial position. Profitability was quite low in international comparison, reflecting on the one hand the severe impact of the recession of the early nineties, and on the other hand the overall impact of firms' restructuring in the transition process.

These results for the overall sample are largely robust to the disaggregation into sub-samples defined according to ownership, size and industry. On average, state-owned firms have lower leverage than private firms and, within the latter group, foreign firms are significantly more leveraged than private domestic firms. State-owned firms also display higher financial debt ratios than domestic private firms, and are the ones characterised by the highest pressure of interest expenses. As for liquidity, the debt structure is similar across ownership types. Profitability is lowest for state-owned firms, in terms of either return on assets or return on equity, reflecting low efficiency as measured by both asset turnover and gross margin. Large firms have lower mean and median debt-asset ratios than small and medium firms, and are characterised by a higher bank debt and coverage ratio. Small firms tend to have a higher fraction of short term debt. Profitability is negatively related to size, largely reflecting a higher asset turnover ratio for small firms.

As for the evolution over time of the distribution of financial positions, the average debt-asset ratio rose between 1989 and 1992, to remain virtually stable after the introduction of the new bankruptcy law. The average debt structure declined gradually throughout the sample period. The high percentage of short term debt appears to be mainly inherited from the past, rather than the outcome of the transition period. The profitability indicators display a procyclical behaviour, following closely the dynamics of the aggregate cycle. Intra-distribution mobility is quite low for all the financial ratios considered, with the only exception of profitability indicators.

The chapter is structured as follows. Section 4.2 briefly reviews the recent empirical literature on corporate financial structures. Section 4.3 provides a description of the set of financial indicators used in this study. Sections 4.4 and 4.5 analyse the sectional distribution of individual financial ratios in the whole sample of firms and by sub-samples (ownership, size and industry), respectively. Section 4.6 examines the distribution dynamics of individual financial ratios.