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## **OPTIMIZATION OF ENTERPRISE'S CAPITAL STRUCTURE**

To optimize the structure of capital is a significant and difficult task, which is solved in the course of enterprise's financial management. The optimal capital structure indicates the ratio of using own and borrowed funds at which the productive factor of proportionality between financial profitability and enterprise's financial viability is provided, that is, its market value increases. But we should take into account a number of subjective and objective factors that have an impact on the capital structure.

As the capital structure performs a direct impact on the final results of the company, one should consider all the properties of both own and borrowed capital. Let us examine the advantages and disadvantages of equity (Table. 1).

Table 1

### Positive and negative features of equity

#### Advantages

- the ease of involvement, because decisions related to the growth of equity are made by company owners and management without the need to obtain the agreement of other economic entities;
- the great potential of profit creating in all the fields, as when it is used it is not necessary to pay interest on loans in all its forms;
- ensuring financial stability of enterprise development and solvency in the long run, and therefore the reduction of the risk of bankruptcy;
- the increase in the financial capacity of the company;
- the ability to make gain in financial return on assets as a result of financial leverage.

#### Disadvantages

- the limited scale of involvement;
- the unused growth prospect of return on equity by taking into account the financial leverage effect;
- the assets emerged due to debt capital, bring the lower rate of income;
- there is the threat of financial risks in economic activity, the decrease of financial stability, solvency, bankruptcy of the company;
- the great dependence of debt costs on the shifts in financial market conditions;
- the complexity of the operation of bringing within large scales in the current environment.

Thus, the companies that use borrowed funds, have mostly excellent financial strength as a result of the formation of additional asset size, but there is an increased risk of bankruptcy here. The task of managing its capital structure is to ensure its optimization. The formation of optimal capital structure is based on a large

number of payments of enterprise's activity indices at different relations of own and debt assets. The optimization of capital structure is carried on the following criteria:

- reducing the average cost of capital;
- the increase in profitability of equity;
- minimization of financial risks.

The optimization of enterprise's capital structure is performed according to the following stages:

The first phase is the analysis of company's capital. The main aim is the manifestation of trends in scale moving and composition of capital before the planning period and their impact on financial stability and efficiency of the capital application. The first stage of the analysis examines the dynamics of total volume and the main components of capital relatively to the dynamics of the scale of production and sales; determines the ratio of equity and debt capital, its tendencies; considers the ratio of long- and short-term financial obligations within the debt capital; underlines the value of urgent financial obligations.

The second stage of the analysis involves the discussion of ratio systems of enterprise's financial stability, which is characterized by its capital structure. In the course of the analysis we calculate and study the change of the following factors:

- 1) the ratio of autonomy;
- 2) the ratio of financial leverage (the ratio of funding);
- 3) the ratio of long-term financial independence;
- 4) ratio of long- and short-term debt.

With the help of the analysis of enterprise's financial stability we can describe the level of stability of its financial growth and extent of financial risks, which form the danger of bankruptcy.

The third stage of the analysis evaluates the effectiveness of use of individual components of capital in general. During the implementation of the analysis we determine the change of the following indicators:

- 1) the period of capital turnover;
- 2) the rate of return on equity;
- 3) capital productivity ratio;
- 4) capital intensity of sales.

The next step is to assess the determining factors that characterize the capital structure formation. There are no ultimate techniques of effective ratio of equity and borrowed capital not only for similar companies, but also for a single business at different stages of its development and with different conditions in commodity and financial markets. But if we take into account a chain of objective and subjective factors, it will allow to generate capital structure consistently and provide the most productive conditions of its application at each specified company. The key of these factors are: the industry characteristics of the enterprise's activities; the life cycle of the enterprise; commodity market conditions; financial market conditions; operating profitability level; the ratio of operating leverage; the relation of creditors to the company; income taxation level; the degree of equity concentration.

Taking into consideration these factors, the management of capital structure in the company has two main directions. They are the optimal levels for the company, using its equity and debt capital, and ensuring the involvement to the enterprise the necessary types and amounts of capital to achieve estimates of its structure.

The next stages are:

1) the optimization of capital structure on the growth standard of financial profitability degree. To perform these optimization calculations the mechanism of financial leverage is used;

2) the optimization of capital on the standard of reducing its cost. The course of this optimization is based on the primary analysis of the cost of equity and debt capital in different conditions of its involving and performing a large number of computing the average cost of capital;

3) the optimization of capital structure on the criterion of the reducing the degree of financial risk. According to this purpose all the assets of the company are classified into three groups: non-current assets; the permanent part of current assets; the variable portion of current assets.

There are three diehard approaches to finance different groups of enterprise's assets:

1) the conservative approach that determines the use of equity and long-term liabilities to create non-current assets, the permanent part and the half of the variable portion of current assets;

2) the compromise approach that provides the funding for non-current assets and the permanent part of current assets at the expense of equity and long-term liabilities. The variable portion of current assets is financed by short-term liabilities.

3) the aggressive approach that provides the guidance on the use of equity and long-term liabilities to finance non-current assets and only the half of the permanent part of current assets. The variable part and the half of the permanent part of current assets appear as a result of short-term debt capital.

Depending on your attitude to financial risks business owners or managers choose one of the varieties of financing assets. The cons of above-mentioned methods are the fact that they include a small number of factors and they are opposite in their directions. As a result, the positive effect of financial leverage effect has increasing profits formed additionally on equity, but also causes worsening financial state, that is the breach of solvency. Increasing financial risks are also caused by minimizing the average cost of capital.

Thus, the optimal capital structure can assume the correlation between equity and debt capital, which will allow the optimal combination of risk and return for the enterprise, maximize the market value of the company, ensure the high level of solvency and financial stability. The main condition of enterprises' financial resources forming at the expense of borrowed funds is drawing capital at low cost and low risk in order to achieve maximum profit. There is no specific definition, with the assistance of which one can calculate the optimal capital structure though any solution must take into account the value of tax payments, business risk, asset quality, the availability of funding.