

DOES THE SELF-FINANCING CAPACITY INFLUENCE THE PERFORMANCE OF ENTITIES LISTED ON THE STOCK EXCHANGE? OMV PETROM S.A. ROMANIA CASE STUDY.

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Abstract

A fundamental element of the results' analysis, the self-financing capacity reflects the potential for sustainability and growth of the entity. The present study uses econometrics methods to analyse the evolution of stock performance of one of the most liquid and appreciated companies listed on the Bucharest Stock Exchange, OMV Petrom S.A., between the years 2004 and 2013, in order to identify the connection between the self-financing capacity of the entity and its stock evolution and we shall demonstrate that despite the absence of a direct correlation between the self-financing capacity and the price of shares, its level has a major impact on the financial return, on the earnings per share and on the general liquidity of the entity, as interest centres for investors.

Keywords: *self-financing capacity, financial return, stock capitalization coefficient, earnings per share, degree of indebtedness*

JEL classification: *M20, M40, M41*

1. Introduction

The present work proposes a global analysis of the self-financing capacity and its impact on the perceived performance of OMV Petrom S.A. by

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the investors on the Bucharest Stock Exchange for the period 2004 – 2013. The central objective of the study is to explore possible connections between key elements specific to the performance analysis of the entities listed on the capital market and the self-financing capacity, as the main indicator of the financial potential of the entity's economic growth. It is intended to describe the impact of the self-financing capacity on the profitability of the entity's economic activities and on its equilibrium, in order to reveal the importance of an efficient use of the resources available to the entity.

The self-financing capacity reflects synthetically “the cash flow available to the enterprise resulting from its activity” (Tertre and Guy, 2008). This renders, in monetary terms, the potential of the entity's growth, by its own funds represented by the potential resources of financing created by the entity through the management of its business. At the same time, this measures the cash potential created by the enterprise through its activity, since the computing approach does not take into account the income and expenses which do not entail entries or cash outflows. To increase its usefulness, the income received and the exceptional payable expenses should be excluded from the calculation.

According to Bogdan (2006), the self-financing capacity determines the level of self-financing, represented by the “own net revenues for capital formation”. At the same time, he considers the self-financing capacity per share to be a relevant measure of efficiency and risk applicable to the entities listed on the stock market. Popa (2011) believes that this indicator is a way to measure “the surplus of resources that the enterprises disposes of for its development and for the payment of its owners”, while according to Niculescu (2005), this is “a global net cash surplus”, a growth factor through the net income component, influenced by the fiscal policy, by the depreciation and the measures taken to increase the profitability of the entity.

According to Petrescu (2010), the self-financing capacity is “a residual balance of flow which represents the difference between the inflows and outflows generated by the current management operations which leave own resources at the disposal of the enterprise so that they should be available to finance various needs, too”. Dumitru (2006) also defines it as “a financial surplus released by the profitable activity of the enterprise” and argues that “it only has a potential character unless it is supported by real financial means”.

The calculation of self-financing capacity can be done in two ways. The descending method (or the subtractive one) has as starting point the gross

operating surplus and it takes into account the receipts and the potential payments of the income and expenses of the company, except those from the surrender of fixed assets and from investment subsidies (Mandou, 2008).

CAF (self-financing capacity) =

Gross operating surplus

+ Transfers of operating expenses

+ Other operating income

– Other operating expenses

+/- The share of the operations made in common

+ Financial income (except income from provisions)

+ Transfers of financial expenses

– Financial expenses (except for those of depreciation and provision nature)

+ Exceptional income (excluding those from the sale of fixed assets, of the share of subsidies for the investments transferred to income and of the exceptional income from provisions)

– Exceptional expenses (excluding the accounting net value of the transferred immobilizations and of those regarding the depreciations and provisions)

+ Transfers of extraordinary expenses

– Employees' participation to the outcome

– Profit tax

According to the descending method (or the additive one), the self-financing capacity shall be determined based on the net result of the exercise (Mandou, 2008):

CAF (the self-financing capacity) =

The net result of the exercise (profit or loss)

+ Depreciation and provisions (on the extraordinary, financial, operating expenses)

– Resumptions of payments and provisions (on extraordinary, financial, operating expenses)

+ Expenses related to the assets transferred and to other capital operations

– Income from the sale of assets and other capital operations

We must iterate that the level of self-financing capacity is a result of the tax, accounting and financing decisions of the company. The self-

financing capacity diminishes with the dividends distributed and as the financial expenses of the entity increase.

By deducting the dividends distributed from the self-financing capacity, we get the level of self-financing. Some authors render an important role to self-financing, considering it the backbone of the entities' financing, the basic, original form of financing since the external financing has the role of an advance on the future self-financing.

2. Literature review

Although there is a consensus in the scientific community about the importance and role of the self-financing capacity, in his work, Charreaux (2007) argues that the literature has addressed this issue insufficiently and incompletely, limiting itself to the implications on the dividend policy of the entity. However, there are studies which enlarge upon the subject of self-financing capacity and the approaches vary according to their main objective.

In his study on a sample of companies listed in France, Atiyet (2012) lays emphasis on the entity's capital structure and, by creating a multifactorial regression model, he identifies a favourable causality link between the self-financing capacity and the creation of value for shareholders (measured by the economic added value and by the market value added). At the same time, Atiyet (2012) concludes that the French entities prefer to self-finance their investment projects, then through debt on medium and long term and only lastly via new issues of shares. Similarly, Samad (2002) has shown that the level of financing from own funds decreases as the amount of the entity's assets increases.

In their work, Liu et al. (2007) state that the information concerning the results of the entity is used in forecasting the securities quotation in the detriment of the self-financing capacity and by the model they have developed, they demonstrate that the forecasting of the result per share is a better measure of the entity's value, due to the great accuracy with which they can be predicted.

In a similar study on the stock exchange in Malaysia, Fah and Mohamed (2008) showed that the usefulness of the self-financing capacity in predicting stock prices weakens as the analysis interval increases and, consequently, they further recommend the analysis based on results, and put those on the account of an increased familiarity of investors towards the result element. Nevertheless, Dhole et al. (2013) showed that using information on

the self-financing capacity entails a reduction in the phenomenon of asymmetry of information which allows more accurate analysis.

In their approach, Cîrciumaru et. al. (2011) analysed four Romanian entities in the automotive industry between 2007 – 2011 and found that the structure and level of self-financing capacity are volatile over time, under the impact of funding and depreciation policies, of provisions and sales profitability, noticing the existence of a correlation between self-financing capacity and the level of financial debt and also an unexpected lack of correlation with the gross operating surplus.

Another line of research was realized by Turóczy and Marian (2012) who developed a multifactorial regression model based on an entity belonging to the ceramic industry, during 2002 – 2011, showing that the level of profit is conditioned by the evolution of the self-financing capacity. Moreover, in their study, Anghel and Man (2014) also demonstrated the existence of a direct connection between the financial performance of an entity (as part of its financial communication) and its evolution on the capital market.

3. Research methodology

A significant importance was given to the selection process of an entity for which the study should be relevant, an entity attractive to investors, bountiful in terms of published information and of possible analysis approaches, which is generally perceived as a liquid, reliable and capable entity to remain profitable regardless of the macroeconomic environment in which it operates. Based on these preliminary criteria, we have decided to choose OMV Petrom S.A., the largest company in Romania that activates in the oil and gas sector, established in October, the 27th, 1997, listed on the Bucharest Stock Exchange since September, the 3rd 2001, under the SNP symbol.

The next step was to develop an econometric study on the relation between the self-financing capacity (CAF) of the entity and its stock performance measured by the earnings per share (EPS), the market capitalization coefficient (PER) and the return on equity (ROE). At the same time, we have decided to verify if this has any direct impact on the price of the shares, but also on the general liquidity, on the general solvency and on the degree of indebtedness OMV Petrom S.A. The period under analysis is 2004 – 2013.

Regarding the research methodology, stages of fundamental, theoretical and practical research have been completed, later there followed the execution of the empirical research methods which include primary data collection, the observation, investigation, financial analysis, ANOVA test, Pearson correlation coefficient, bivariate regression. At the same time, quantitative methods have been used to systematize the necessary information specific to the selected sample, and for data processing we have used Microsoft Excel and SPSS. It should be noted that the work is based on official data and information (annual financial statements and annual activity reports), supplied by the analysed entity, the Bucharest Stock Exchange and the Ministry of Public Finance.

Statistical correlation is “the reflection of the objective interdependences between processes and phenomena in an adequate numerical form” (Săvoiu, 2011). For the present paper, we have chosen to apply the Pearson correlation coefficient which is a measure of linear correlation between two variables and which can take values between + 1 and – 1. Value 1 renders a positive correlation, 0 indicates no correlation and – 1 denotes an overall negative correlation. Knowing that r is the correlation coefficient, n the number of years, x the independent variable and y the dependent variable, the formula for calculating the Pearson correlation coefficient is as follows:

$$r = r_{xy} = \frac{n \sum x_i y_i - \sum x_i \sum y_i}{\sqrt{n \sum x_i^2 - (\sum x_i)^2} \sqrt{n \sum y_i^2 - (\sum y_i)^2}}$$

The statistical regression “selects the function, which belongs to a class of mathematical functions, which achieves the best description of the variable y_i , relying on the existent relationship between x_i și y_i , a linear relationship of the type $y_i = a + bx_i$ ” (Săvoiu, 2011), where y_i is the dependent variable, and x_i is the independent variable or the predictor. In addition, the analysis of variance (the ANOVA test) consists in carrying out calculations which provide information on the level of variability within the regression model and form a basis to test its significance (www.stat.yale.edu).

4. Research structure. Results and discussion.

For a better delineation of the topics studied we have divided the study into two complementary sections. The first section briefly characterizes the evolution of the self-financing capacity and analyses the connections that the self-financing capacity establishes with the indicators that directly

characterizes the stock performance of the entity subject to the study, while the second section seeks to identify connections between the self-financing capacity and the indicators of the financial position of the entity, in order to explain the results obtained in the first section.

Considering all the presented, we have proceeded to formulate the following assumptions of the research:

H₁: The self-financing capacity does not affect the share price, the alternative hypothesis being that the self-financing capacity affects the share price.

H₂: The self-financing capacity does not affect the coefficient of stock capitalization, the alternative hypothesis being that the self-financing capacity affects the coefficient of stock capitalization.

H₃: The self-financing capacity does not affect the financial return, the alternative hypothesis being that the self-financing capacity affects the financial return.

H₄: The self-financing capacity does not affect the earnings per share, the alternative hypothesis being that the self-financing capacity affects the earnings per share.

In order to explain the results of the first hypotheses verification and since the self-financing has also an impact on other indicators tracked by investors, the formulation of additional hypotheses has been called for:

H₅: The self-financing capacity does not affect the general liquidity, the alternative hypothesis being that the self-financing capacity affects the general liquidity.

H₆: The self-financing capacity does not affect the general solvency, the alternative hypothesis being that the self-financing capacity affects the general solvency.

H₇: The self-financing capacity does not affect the degree of indebtedness, the alternative hypothesis being that the self-financing capacity affects the degree of indebtedness.

4.1. Self-financing capacity and stock performance

In terms of general evolutionary trend, the self-financing capacity increased in the first four years subject to analysis, followed by a slight decrease in 2007 and a recovery in 2008. Although in 2009 there was a new decline, the growth trend was resumed starting with the year 2010. This way, the premises to support the economic growth of the entity are designed.

Maximum is reached in 2013 as a direct result of the company's record in terms of profit and minimum in 2004, the only year with a loss.

Furthermore, in terms of self-financing and according to development needs, the entity practised a policy of reinvesting the profit in 2008 and 2009, a period when the entire profit was directed towards own sources of funding. The entity chose to distribute dividends only in the years when the outcomes and the development needs of the entity allowed this.

The self-financing capacity and self-financing strongly and positively correlate (Pearson correlation coefficient being of 0.9526) due to the determination method of the latter. Self-financing presents additional variation imprinted by the dividend policy decisions. We also notice that the distribution level of dividends is also in close positive correlation with the self-financing capacity, the correlation coefficient being of 0.7865, a result that reinforces what has been previously said. We can also state that the entity attracts steadfast investors, orientating towards majority shareholders interested in increasing the business as a value, not exclusively in the dividend.

The self-financing capacity per share renders own sources of funding that are due to one share, an indicator that is also increasing from one year to another, at the same time as the self-financing capacity is ascending. In addition, the coverage capacity of the dividends measures the proportion to which the net profit is distributed as dividends. Although the minimum level is considered 2.5, the company has values under the level recommended each year when it decides the distribution of dividends. Since the indicator is relevant to the safety of dividends payment, the inclination towards the policy to increase the self-financing capacity is reiterated so as to support future plans of the entity's development.

We proceed to testing the hypotheses belonging to the first part of the studied issue. By analysing the value of the Pearson correlation coefficient between the self-financing capacity (CAF) and the price per share, we note that the two variables correlate inversely, but very weakly (- 0,022) and at an insignificant level, since the significance test Sig or the p value (0,951) far exceeds the accepted threshold of significance (0,05). So, if we continued the analysis and built a statistical-mathematical pattern to include the both variables, this wouldn't be conclusive. Consequently, we accept as valid the first hypothesis (H_1) and admit that the share price is not directly influenced by the self-financing capacity.

The market capitalization coefficient, obtained by dividing the share price to the earnings (the profit for shareholders) per share, reflects the investment risk depending on the company's development. Regarding the relationship between CAF and the market capitalization coefficient (PER), we should mention that the two variables also correlate weakly (0,117) and to an insignificant level (0,749). This way the second hypothesis (H₂) is confirmed and we can state that PER is not influenced by CAF in its evolution.

The return on equity (ROE) expresses the use efficiency of the entity's equity and represents a major centre of interest for shareholders. It is obtained by dividing net earnings to equity. If we look at the connection between CAF and ROE, in average ROE is 11,90%, and CAF is 3.869.709.056,40 lei. The two variables correlate strongly, positively and significantly (0,024), the Pearson correlation coefficient being of 0,701. Hypothesis H₃ is rejected, we therefore assume the alternative hypothesis according to which the self-financing capacity influences the financial return. Therefore we can proceed to building a regression model where CAF is the predictor, while ROE is the dependent variable.

Table 1: The ANOVA test – ROE dependent variable, CAF predictor

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0,033	1	0,033	7,719	0,024 ^b
	Residual	0,035	8	0,004		
	Total	0,068	9			
a. Dependent Variable: ROE						
b. Predictors: (Constant), CSF						

Source: Authors' projection in SPSS

Table 2: Model summary – ROE dependent variable, CAF predictor

Model Summary ^b										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0,701 ^a	0,491	0,427	0,06582	0,491	7,719	1	8	0,024	1,539
a. Predictors: (Constant), CSF										
b. Dependent Variable: ROE										

Source: Authors' projection in SPSS

Thus, the independent variable explains the evolution of the dependent variable at a rate of 49,10%, and the bivariate regression equation becomes:

$$ROE = - 0.10 + 3.37 \times 10^{-11} \times CAF \quad (1)$$

We should mention that the low value of the cash flow coefficient is due to its high absolute value (of 10 digits above unit).

Table 3: Coefficients – ROE dependent variable, CAF predictor

Coefficients ^a												
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B		Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	-0,010	0,051		- 0,847	-0,128	0,107					
	CSF	3,337 E-11	0,000	0,701	2,778	0,024	0,000	0,000	0,701	0,701	0,701	1 1

a. Dependent Variable: ROE

Source: Authors' projection in SPSS

For the major shareholder, an increasing evolution net return per share is a signal of the company's profitability. In conjunction with earnings per share (EPS), the self-financing capacity (CAF) correlates very strongly and positively and this is a highly significant connection. Moreover, CAF explains the evolution of EPS at a rate of 85,30%. We must add that during the analysed period, from 2004 until 2013, the earnings per share indicator was on average of 0,038 lei/share.

This being said, the fourth hypothesis (H₄) is rejected and the alternative hypothesis is accepted according to which the self-financing capacity influences the earnings per share.

Table 4: The ANOVA test – EPS dependent variable, CAF predictor

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0,008	1	0,008	46,247	0,000 ^b
	Residual	0,001	8	0,000		
	Total	0,009	9			

a. Dependent Variable: EPS

b. Predictors: (Constant), CSF

Source: Authors' projection in SPSS

Table 5: Model summary – EPS dependent variable, CAF predictor

Model Summary ^b										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0,923 ^a	0,853	0,834	0,01285	0,853	46,247	1	8	0,000	1,896
a. Predictors: (Constant), CSF										
b. Dependent Variable: EPS										

Source: Authors' projection in SPSS

Using the data provided in the previous table, we have built the final form of the regression model as follows:

$$EPS = - 0.24 + 1.595 \times 10^{-11} \times CAF \quad (2)$$

Table 6: Coefficients – EPS dependent variable, CAF predictor

Coefficients ^a													
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
		1	(Constant)	-0,024			0,010		-2,385	0,044	-0,047	-0,001	
	CSF	1,595 E-11	0,000	0,923	6,801	0,000	0,000	0,000	0,923	0,923	0,923	1,000	1,000

a. Dependent Variable: EPS

Source: Authors' projection in SPSS

4.2. The self-financing capacity and the financial position of the entity

The second part of the study seeks for possible connections between the self-financing capacity and a group of indicators representative for the overall financial position of the entity. This section is introduced to further explain and strengthen the results obtained during the first section of the study.

Table 7: The ANOVA test – Gen_liquidity dependent variable, CAF predictor

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7,469	1	7,469	9,860	0,014 ^b
	Residual	6,060	8	0,758		
	Total	13,530	9			
a. Dependent Variable: Gen_liquidity						
b. Predictors: (Constant), CSF						

Source: Authors' projection in SPSS

General liquidity is obtained by dividing current assets to current liabilities and it renders the capacity of patrimonial elements to be converted into cash and its equivalents. On average, the overall liquidity was of 1,998, an optimal value and a sign of financial equilibrium of the economic entity.

We have also found that between CAF and the general liquidity there is a negative, close and significant correlation (-0,743), and CAF explains the level of the dependent variable at a rate of 55,20%. Consequently, the H₅ hypothesis is rejected and we can state that overall liquidity is influenced by the self-financing capacity. This is an anticipated result since an efficient operational activity leads to a healthy level from a financial point of view of the self-financing capacity which in turn brings upon a safe level of liquidity.

Table 8: Model summary – Gen_liquidity dependent variable, CAF predictor

Model Summary ^b										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0,743 ^a	0,552	0,496	0,87037	0,552	9,860	1	8	0,014	0,832
a. Predictors: (Constant), CSF										
b. Dependent Variable: Gen_liquidity										

Source: Authors' projection in SPSS

Table 9: Coefficients – Gen_liquidity dependent variable, CAF predictor

Coefficients ^a														
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics		
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF	
		1	(Constant)	3,928			0,673		5,833	0,000	2,375	5,481		
	CSF	-4,987	0,000	-0,743	-	0,014	0,000	0,000	-	-0,743	-	-	1	1
		E-10			3,140				0,743	0,743				
a. Dependent Variable: Gen_liquidity														

Source: Authors' projection in SPSS

By using the information from the previous table, we have built the simple linear regression model:

$$\text{Gen_liquidity} = 3.928 - 4.987 \times 10^{-10} \times \text{CAF} \quad (3)$$

General solvency has been calculated by dividing total assets to total liabilities and it represents the capacity of the entity to meet its obligations at maturity. Regarding the relationship between the self-financing capacity and

the general solvency, we must mention that the two variables correlate weakly (-0,421), negatively and at an insignificant level (0,225). Thus, the sixth hypothesis (H_6) is confirmed and we can say that general solvency is not influenced by the self-financing capacity.

There is a similar situation in the case of the degree of indebtedness which correlates loosely (0,170), positively, but insignificantly (0,639) with CAF, so the H_7 hypothesis is admitted and we can state that the degree of indebtedness is not influenced by the self-financing capacity. The degree of indebtedness has been calculated as the ratio between the financial debt and own equity.

In addition, in order to explain the generating elements of the self-financing capacity, we have analysed its relationship with the added value and with the gross operating surplus and we have noticed, as expected, that it correlates significantly, very strongly and positively with the added value (0,987) and with the gross operating surplus (0,965).

5. Concluding remarks

To conclude, the self-financing capacity expresses the level of the financial resources generated by the normal activity of the entity after deducting the expenses that had led to the release of revenue. This should ensure the growth of the company and the remuneration of the shareholders in the form of dividends. Furthermore, the management of the entity builds the financial and investment policy in correlation with its level. Thus, a high level of self-financing ensures the remuneration possibility for investors and of an efficient use of their funds. The interest in the self-financing capacity is due to the fact that it conditions the dividend policy and makes it possible to determine the capacity to repay liabilities (Mandou, 2008).

At the same time, the self-financing capacity is a polyvalent indicator which connects the profit and loss account to the functional financing board and which links the results analysis and the financing decision. Its importance derives also from its role in strengthening the working capital, in assuring dividend distribution capacity, in ensuring investments needs or the timely repayment of debts for investments.

Also, the importance of self-capacity is revealed by the uses that theory and practice confers it, namely: performance indicator of the company, basic variable of different models of bankruptcy risk (such as the model of French Central Bank, which divides it to total debts), risk and efficiency

measure of the entities listed on the capital market, fundamental element of the dynamic analysis of the bankruptcy risk and measure which conditions the access to external financing sources.

The results of the study led to validate or reject the hypotheses formulated. The first part of the study as dedicated to exploring the connection between the self-financing capacity and the stock performance. At the beginning, the first hypothesis was validated according to which the self-financing capacity does not influence the price per share. We must mention that this result cannot completely deny the importance that the self-financing capacity has and its impact on the financial position of the entity in general. As well, the second hypothesis was validated and it states that there is no impact of the self-financing capacity on the stock capitalization coefficient. Nevertheless, as anticipated, the following two hypotheses were rejected and we accepted their alternatives according to which the self-financing capacity significantly influences the financial return, a measure of equity efficiency and the result per share that is frequently used by investors as a performance measure that bears great importance in the comparisons between same sector entities. Therefore, although in the present study the self-financing capacity does not present a direct and significant impact on the share price, it significantly affects indicators and analysis elements sought for by investors in the process of investment decision substantiation.

The second part of the study focused on the links between the self-financing capacity and the indicators on the overall financial position of the entity. The only rejected hypothesis of this section confirms that general liquidity is influenced by the self-financing capacity. This is an anticipated result, since an efficient operational activity leads to a healthy level of the self-financing capacity which attracts the financial stability of the entity. However, the last two hypotheses, according to which the self-financing capacity influences neither the overall solvency nor the degree of indebtedness, are accepted as valid.

Furthermore, we have noticed that the importance of the self-financing capacity is additionally given by the strong connection it has with the added value and with the gross operating surplus, elements which at the same time determine its level and evolution.

This paper contributes to the enrichment of the financial-accounting theory with empirical experiences, through an approach extended beyond the traditional methods of financial analysis. However, we must admit that the

current study has a series of particular limits, such as the low number of statistical observations and the limitation of the study of the analysis of connections between the self-financing capacity and the indicators of stock performance. Consequently, the study can be extended to a larger sample of entities listed on the capital market in order to develop an econometric model with general or sectorial applicability.

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