MANAGEMENT PRACTICE

DETERMINANTS OF SHORT-TERM LIABILITIES OF FINANCIALLY DISTRESSED SME-S

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Abstract: The article studies the determinants of short-term liabilities of financially distressed small and medium-sized enterprises in Bulgaria. The research is based on data from the financial statements of one hundred non-financial enterprises in different industries in the period from 2014 to 2016, provided by the National Statistical Institute.

A company is defined as financially distressed if it cannot cover its short-term liabilities with its operating cash flow. By employing multiple regression analysis, we design a model, which shows the positive impact of the levels of net sales revenue, inventory, receivables from customers and suppliers and financial assets, and the negative impact of the ratio of current assets to total assets on the short-term debt of financially distressed SME-s.

Key words: default risk; financial distress; short-term indebtedness.

JEL: G30, G32, G33.

Introduction

Failure risk of enterprises has been subject to numerous research works for decades, yet a number of issues related to the causes of that risk

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and the possibilities for managing it remain unresolved. Identifying the factors which pose a failure risk for enterprises in the country could enable decision-makers adopt appropriate measures for reducing that risk.

A common interpretation of indebtedness and liquidity in related literature is a situation in which an enterprise is not able to service its debts. When companies do not have sufficient available resources to make prompt payments on their current debts, their survival depends on a number of factors such as their ability to attract external funding and the tolerance of their creditors. While the possibility to refinance a debt at a certain moment of a liquidity crisis relates to a number of factors that are external to enterprises and implies high risk and financial costs, it is within the control of a company to plan and manage the curve of its short-term indebtedness so as to prevent liquidity problems and avoid bankruptcy.

Planning short-term indebtedness enables companies to largely prevent problems related to refinancing their debts during critical times. In order to do so, companies need to clearly identify the determinants of their short-term indebtedness.

The object of this research are non-financial small and medium-sized enterprises in Bulgaria. The subject of the research is their short-term indebtedness. The aim of the paper is to identify the determinants of short-term indebtedness of financially distressed small and medium-sized enterprises in the country.

Theoretical Review

One of the challenges to analysing the failure risk for companies is the lack of a single definition of the phenomenon, which renders it difficult to compare the results of numerous research works in the sphere. Most authors tend to use narrow legal definitions of bankruptcy since this facilitates the process of collecting data (Lukason and Hoffman, 2014, Balcaen and Ooghe, 2004). The disadvantage of such an option is that there might be differences in the legal definition of bankruptcy in different countries.

A lot of authors prefer to use the term 'financial distress' when choosing a dependent variable for their analysis (Balcaen and Ooghe, 2004;

Platt and Platt, 2002). Yet, different authors have different views about what should be defined as a situation of financial distress. According to Platt and Platt (2002), companies are in financial distress when: 1) their net operating income has been negative for several years; 2) they cancel their dividend payments, or 3) engage in major restructuring or downsizing. John (1993) points out that financial distress results from the discrepancy between the current assets and the financial obligations of enterprises, therefore the mechanism for dealing with financial distress requires reconstructing the asset structure or the contractual liabilities of enterprises. Dyrberg (2004) defines as companies in financial distress inactive enterprises which have officially been declared bankrupt, companies facing compulsory liquidation and active enterprises which have used write-offs or have gone through compulsory sales. According to Sun, Li, Huang, and He (2014), financial distress is the inability of an enterprise to fulfil its debt obligations, which results in insolvency, liquidation or another type of confiscation and redistribution of assets. According to McLeay and Omar (2000), making losses and selling assets to private investors, capital restructuring and accumulation of losses indicate financial distress. Froot, Scharfstein and Stein (1993) define entities with low cash flows as companies in financial distress. Theodossiou (1993) believes that the failure of an enterprise may easily be predicted when an entity has not published its financial statements for at least two years. Elloumi and Gueyie (2001) state that companies with negative earnings per share (EPS) are in financial distress. The EPS ratio is indicative of the prospects to the future earnings of a company (Elloumi and Gueyie, 2001). According to Nenkov (2015, p. 201), 'many investors are ready to pay a price that is much higher than the average for a unit of current income' since they assume that high values of the ratio between the market price per share and the EPS is a major indicator of a growing company income in future.

The concept that there is a direct relationship between the liquidity problems, which companies are facing, and the risk of failure they are exposed to is generally accepted in financial theory (Bolek and Grosicki, 2015, p. 50). Barbosa (2014) emphasizes that good management of working capital is essential to the financial stability of enterprises and their ability to pay debts. In order to assess operations-based vulnerability and failure risk,

Barbosa (2014, p. 9) studies the cash assets, the trade receivables and the trade payables, the inventories and the investments of enterprises. Petersen and Rajan (1997) state that involuntary extension of trade credit and difficulty in collecting overdue receivables from companies with financial problems suggest financial distress costs. According to Raykov (2017, p. 27), the management of working capital is of vital importance, especially during a crisis, when the access of companies to funding is more difficult.

Cash in hand is the most liquid asset of companies. The importance of cash in hand to the failure risk which companies are exposed to has been subject to numerous research works. Quader and Abdullah (2016) analysed data about 5,086 companies in seven European countries (Belgium, France, Germany, Italy, the Netherlands, Sweden and Great Britain) in the period from 1981 to 2010 to study the impact of financial distress on the international corporate policies of enterprises, based on their demand for liquidity. They arrived at the conclusion that financially distressed companies seek to save considerably more cash than companies, which are not experiencing financial difficulty. Sufi (2009) also proved that financially distressed enterprises which do not have access to credit lines are more likely to hold larger volumes of cash as precaution. Kling (2012) developed a model of cash holding that focused on the short-term liquidity shocks faced by companies with uncertain net working capital. He proves that in the absence of certain cash flows, cash holding reduces the default risk, thus enhancing a company's access to short-term bank financing. At the same time, Kling (2012, p. 11) points out that the higher the financial leverage, the smaller the partial impact of cash holding on reducing the default risk, i.e. the default risk is not lower for companies with high financial leverage and high cash holdings.

Contrary to the belief that firms with higher cash holding should be 'safer' and have lower credit spreads, Acharya, Davydenko and Strebulaev (2012) establish a robustly positive correlation between cash in hand and spreads. Their research finds out that riskier firms accumulate higher cash reserves. The authors explain that positive correlation with the precautionary motive of cash holding. Acharya, Davydenko and Strebulaev (2012) conclude that companies with higher cash holding are less likely to default in the short-term, as intuition may suggest, yet liquidity is positively related to

the default probability in the long run. The findings of their research indicate that a conservative working capital management policy is implemented by companies, which are aware that they are close to a situation of financial distress. When the default risk goes up, companies increase their liquid assets.

Faulkender and Wang (2006) point out that corporate liquidity enables firms to make investments without having to access external capital markets, thus reducing the risk of financial distress which arises when companies do not have sufficient cash flows to cover their debt. Acharya, Davydenko and Strebulaev (2012) emphasize that managers choose the optimal cash policy taking into account the probability of default over the long term but in the presence of market frictions it is difficult for distressed companies to adjust their cash balances to desired levels on a short notice. Therefore, according to Acharya, Davydenko and Strebulaev (2012, p. 15), the relationship between cash and default in the short term should be studied conditional on the past cash and investment choices of enterprises.

García-Teruel, Martínez-Solano and Sánchez-Ballesta (2008) analyse the effect of accounting information quality on cash holding. They use panel data about 65 companies listed in the Spanish stock exchange over the period from 1995 to 2001. The findings of their research show that companies with good quality of their accounting information hold less cash than companies with low quality of their accounting information. The authors come to the conclusion that the quality of accounting information may reduce the negative effects of information asymmetries and adverse selection costs, thus allowing firms to reduce their level of corporate cash holdings. García-Teruel, Martínez-Solano and Sánchez-Ballesta (2008) also point out that companies with high-quality financial statements have less information asymmetries and lower adverse selection costs, which affects their financing costs and their investment efficiency. Companies with high-quality financial statements do not need high cash holdings in order to fund their projects, which enables them to reduce the unproductive investments in their balances (García-Teruel, Martínez-Solano and Sánchez-Ballesta, 2008). García-Teruel, Martínez-Solano and Sánchez-Ballesta (2008) also establish that cash holdings decrease when firms increase their use of bank debt and in the presence of cash substitutes.

Taghavi and Javanmard (2013) also study the impact of accruals quality on the cash holdings of companies. They use data about 120 companies listed in the Tehran stock exchange during the period from 2001 to 2011. Similar to García-Teruel, Martínez-Solano and Sánchez-Ballesta (2008), they establish that the quality of accounting information may reduce the negative effects of information asymmetries and adverse selection, allowing firms to reduce their level of corporate cash holdings. Cash holdings decrease when firms increase their use of bank debt and in case of investment in other liquid assets. They also find out that larger companies and financially distressed ones have higher cash holdings. At the same time, Taghavi and Javanmard (2013) did not establish any relationship between the levels of cash holding and growth options, leverage, opportunity costs, dividends and the capacity of firms to generate cash flows.

Al-Amri, Al-Busaidi and Akguc (2015) establish a positive correlation between accounting conservatism and the amount of corporate cash holdings. The authors define the level of cash holdings as a major element that contributes to the survival of a company. Accounting conservatism is the understatement of net assets and earnings (Al-Amri, Al-Busaidi and Akguc, 2015). By running a pooled regression, Al-Amri, Al-Busaidi and Akguc (2015) establish a positive relationship between the level of companies' cash holdings and accounting conservatism, which is robust even after controlling for other variables that affect the level of cash holdings. Accounting conservatism therefore serves as a monitoring mechanism to reduce management's incentives to invest in negative net present value projects and thus preserve cash (Al-Amri, Al-Busaidi and Akguc, 2015, p. 102).

Analyses based on the data presented in financial statements are expected to give objective awareness about the condition of companies. We should bear in mind though, that enterprises may manipulate the data in their financial statements in order to give a more optimistic presentation of their financial situation. The incentives to do so are stronger for companies facing default (Argenti, 1976; Rosner, 2003). Therefore, when predicting financial distress, corporate cash flow that is more difficult to manipulate should be given priority over traditional correlations, which are based on accounting

accruals (Carslaw and Mills, 1991; Mills and Yamamura, 1998). Jooste (2007) defines the ratio between cash flows and total debt as the most reliable indicator of forthcoming default. One of the unmistakable signals that a financial statement has been manipulated is a value below 1 of the ratio between working cash flow and net earnings (Eusebio, 2016).

Another fact that is frequently stated in financial theory is that the default risk for companies depends on the maturity structure of their debt. Giannetti (2016) pays attention to the disadvantages of short-term debt. It may lead to the liquidation of companies, which do not have access to other funds to meet debt repayments (Diamond, 1991). The impact of short-term debts and, in particular, the risk arising from the need to refinance such debts is emphasized by a number of authors (Chen, Hui, Yu Xu and Yang, 2013; Dang and Phan, 2016; Parise, 2017). Chen et al. (2013) point out that the default of non-financial institutions like Lehman Brothers and Bear Stearns during the financial crisis was due to the materialized risk related to refinancing the enormous short-term debts of those companies. Diamond (1991) pays attention to the fact that in the presence of credit market frictions, firms may face difficulty in rolling over short-term debt, especially if refinancing coincides with a deterioration in the condition of a company. Some authors also argue that the risk related to refinancing or the liquidity risk may themselves be additional sources of credit risk because short-term debt increases the possibility of run on the firm and may exacerbate the conflict of interest between debt holders and shareholders (Dimitrov, Palia and Tang, 2015; He, Zhong, Lütkebohmert and Xiao, 2017; Wang and Zhang, 2017). Shorter-term debts also entail higher information asymmetries (Stohs and Mauer, 1996).

Antoniou, Guney and Paudyal (2006) and Valta (2016) claim that an optimal maturity debt structure may reduce the equity costs and the default risk of companies. Firms manage multiple bond issues with different times maturities to mitigate rollover risk and debt overhang (Giannetti, 2016; Diamond and He, 2014). It is less costly for a firm to be exposed to small rollover risks rather than to be exposed to a large rollover risk. In addition, corporate debt becomes more granular during economic downturns when rollover risks are higher (Giannetti, 2016). In their theoretical analysis De

Fiore and Uhlig (2015) show that the ability of firms to substitute among alternative instruments of debt finance are important to shield the economy from the adverse real effects of a financial crisis.

Sajjad and Zakaria (2018) point out that financial managers and investors approach credit ratings as measurers of financial problems. Sajjad and Zakaria (2018) establish that Asian companies with high and with low ratings have a shorter debt maturity structure, in contrast to companies with medium ratings which have a longer debt maturity structure. They also establish that liquidity is negative correlated to longer debt maturity structures. The findings of their research indicate that companies with high ratings and high liquidity and companies with low ratings and lower liquidity have shorter debt maturity. Mid-rated firms with a low probability of a refinancing risk show a longer debt maturity structure. When considering the refinancing risk, a non-linear relationship is established between credit ratings and debt maturity choices.

Diamond (1991, p. 709) claims that borrowers with high credit ratings prefer short-term debts, while those with lower credit ratings prefer long-term ones, yet borrowers with lower ratings may only manage short-term debt. Diamond (1991, p. 730) also states that financing through a short-term debt which is larger than the cash flow gives to debt-holders substantial control as borrowers can only pay off their existing debt if they make a new debt. Unless a company is able to pay off its debt, debt holders may require that it be declared bankrupt or they may take control over the company through alternative methods.

An Empirical Analysis of the Determinants of Short-term Debt of Financially Distressed Companies

We conducted a research of one hundred small and medium-sized enterprises according to the criterion 'number of persons employed' over the period from 2014 to 2016 by using data provided by the National Statistical Institute (NSI). The research sample is structured so as to include SME-s

from nearly all sectors of the Classification of Economic Activities (NACE.BG-2008), with the exception of the sectors of Finance and Insurance, State Government, Activities of Households as Employers, Activities of Exterritorial Organisations and Bodies. We selected the companies operating in the different sectors randomly and used the SPSS software package to process data. The research methods we employed are analysis and synthesis, descriptive statistics, Pearson's correlation coefficient and multiple regression analysis. We set the α risk to 0.05 and used pooled data in our research.

The high share of defaulted and uncollectible receivables in the country and the fact that cash flows are more difficult to manipulate than traditional accounting indicators are two arguments in favour of using the value of cash flows when analysing the default risk for SME-s. Furthermore, we should also take into account the significant share of grey economy in the country. For most of the companies in the research sample, the ratio between the Cash flows from operating activities and their Net Earnings is less than 1, which implies that the accounting information has been subject to manipulation.

Collected data also indicate that over the researched period, i.e. from 2014 to 2016, the ratio between the Cash flows from operating activities and the Current liabilities was less than 1 for 213 out of 300 researched companies. We could therefore assume that there are serious indications of financial distress for more than two-thirds of the companies in the research sample.

The survival of those companies depends on their reserves and the ability to attract external funding. In the period from 2014 to 2016, the mean value of the ratio between the Cash flow from operating activities and the Current debt increased, yet there were a number of changes in the values of short-term liabilities, which indicates that some of the companies were facing serious difficulty in paying their liabilities. This is also suggested by the changes in the median value of the ratio Cash flow from operating activity/Current debt.

Table 1.
Dynamics of the indicators of the burden of short-term liabilities in financially distressed companies

Mean value	2016	2015	2014
Cash flow from operating activity/Current debt	-0.060	-0.020	-0.293
Current liabilities	1511.44	1556.69	1554.90
Accounts payable	560.65	571.49	604.84
Short-term liabilities / Total assets	0.361	0.434	0.488
Short-term liabilities / Long-term liabilities	10.452	18.964	23.338
Short-term liabilities / Net sales revenue	0.457	0.361	0.383
Median value	**2016**	**2015**	**2014**
Cash flow from operating activity/Current debt	0.055	0.136	0.140
Short-term liabilities	657.00	610.50	582.50
Accounts payable	162.00	175.50	151.00
Short-term liabilities / Total assets	0.287	0.279	0.264
Short-term liabilities / Long-term liabilities	2.667	1.291	1.739
Short-term liabilities / Net sales revenue	0.273	0.233	0.256

Source: Computations made by the author of the research

The decrease in the median value of the coefficient indicates that for some of the researched companies it became increasingly difficult to cover their current debts with the cash flow from their operating activity. The mean value of short-term liabilities declined over the researched period. In contrast, there was an upward trend in the median value of short-term liabilities. In 2014, the short-term liabilities of half of the financially distressed companies amounted to no more than 582.5 thousand BGN, their value reaching 610. 5 thousand BGN in 2015 and 657 thousand BGN in 2016.

There was a similar difference in the trends in the mean and the median values of the ratio between Short-term liabilities and Total assets. The value of the ratio between Short-term liabilities and Total assets for half of the financially distressed companies did not exceed 0.264 in 2014, then reached 0.279 in 2015 and 0.287 in 2016. This, too, was an indicator of the deteriorating condition of some of the companies.

There were also changes in the debt structure with an upward trend in the share of long-term liabilities. The mean value of the ratio between Short-term liabilities and Long-term liabilities declined significantly. Apparently, this indicates a declining short-term default risk for companies, which are unable to cover their current liabilities with the cash flow from their operating activity. The trend in the median value of the ratio over the researched period was the opposite, which, too, indicates that for some of the financially distressed companies, the problem of covering their growing short-term liabilities exacerbated.

Companies facing serious financial problems often find it difficult, and sometimes impossible, to attract long-term funding. Their growing need of external funding thus results in growing short-term indebtedness.

Another indicator of the exacerbating problem faced by the SME-s, which did not generate sufficient cash flow from their operating activity to cover their current liabilities, is the dynamics of their accounts payable during the period. While there was a gradual decrease in its mean value, there were fluctuations in the median value, which was higher in 2015 and in 2016 than it was in 2014. Companies facing higher default risk have higher accounts payables since their access to funding from alternative sources is limited. In addition, suppliers are generally more tolerant creditors than banks are.

An alarming fact was the growth of the mean and the median values of the ratio between Short-term liabilities and Net sales revenue in 2016. It indicated that a smaller amount of net sales revenue was available to cover a single lev (BGN) of current liabilities.

A substantial share of the companies went into short-term debt, which they did not have the capacity to pay off with the cash flow generated from their operating activity. We employed multiple regression analysis to study the determinants of short-term indebtedness of small and medium-sized non-financial enterprises in financial distress. Identifying the determinants of the level of short-term debt of financially distressed companies makes it possible to determine the aspects which managers should focus their work on so as to improve the management of and reduce the default risk for their enterprises.

The dependent variable is the value of the short-term liabilities of companies whose ratio between Cash flow from operating activity and Short-

term liabilities is less than 1. The independent variables in the model are the Net sales revenue; Inventories; Accounts receivable from customers and suppliers; Financial assets and the Ratio between Current Assets and Total Assets.

Table 2.
Descriptive statistics of factor variables

	Net sales revenue	Inventories	Accounts receivable from customers and suppliers	Financial assets	Ratio between Current Assets and Total Assets
Mean	6058.07	948.87	817.73	545.41	0,6073
Median	2,264.00	151.00	220.00	160.00	0.6198
Mode	220*	0.00	0.00	0.00*	1.00
Minimum value	24.00	0.00	0.00	0.00	0.03
Maximum value	103,444.00	25,942.00	13,927.00	10,054.00	1.00
Asymmetry	4.85	6.37	4.60	5.33	-0.34
Excess	29.72	48.54	23.27	32.809	-0.88
Coefficient of variation	196.55%	285.39%	247.56%	235.98%	41.98%

* There are several mode values, this table shows the lowest one.
Source: Computations made by the author of the research

The characteristics of the model are:
Correlation coefficient (R) – 0.903
Determination coefficient (R^2) – 0.816
Adjusted R^2 – 0.812
F statistic – 183.535
Sig. – 0.000

The model is adequate, the significance level of criterion F, sig. = 0,000 < α = 0, 05. The cumulative effect of the factor variables employed in the model explains 81.6 % of the changes in the dependent variable. All factors in the model are significant (sig. < 0, 05).

Table 3.
Values of the explanatory variables in the model

	B (unstandardized coefficients)	Std. Error	Beta (standardized coefficients)	t	Sig.
Constant	658.538	218.197		3.018	0.003
Net sales revenue	0.062	0.013	0.264	4.743	0.000
Inventories	0.432	0.042	0.420	10.323	0.000
Accounts receivable from customers and suppliers	0.473	0.052	0.343	9.174	0.000
Financial assets	0.396	0.093	0.182	4.241	0.000
Ratio between current assets and total assets	-828.909	332.472	-0.076	-2.493	0.013

Source: Computations made by the author of the research

None of the coefficients in the correlation matrix has a value exceeding 0.7 (except for the values along the main diagonal axis). This indicates the presence of multicollinearity, i.e. the factor variables are independent from one another. Provided that there is multicollinearity, 'the assessed regression coefficients are inefficient, i.e. with wide confidence intervals, which renders them unreliable' (Goev, 1996, p. 162).

Table 4.
Correlation matrix of the factors in the model

	Net sales revenue	Inventory	Accounts receivable from customers and suppliers	Financial assets	Ratio of current assets to total assets
Net sales revenue	1	0.596	0.542	0.648	0.052
Inventory	0.596	1	0.172	0.154	0.027
Accounts receivable from customers and suppliers	0.542	0.172	1	0.502	0.170
Financial assets	0.648	0.154	0.502	1	0.104
Ratio of current assets to total assets	0.052	0.027	0.170	0.104	1

Source: Computations made by the author of the research

In terms of the impact of the different factors that are used in the short-term liabilities model of SME-s whose ratio between Cash flow from operating activity and Short-term liabilities is less than 1, we establish the following:

- **Net sales revenue** – The value of the net sales revenue indicates the size of companies, their position and competitiveness on the market, the quality of their management and information transparency, as well as their creditworthiness at large. Companies with higher net sales revenue have higher short-term liabilities due to the wider volume of their operation and their relatively easy access to external funding in contrast to smaller companies. Furthermore, a large share of the domestic sales is made with deferred payment, which forces the companies that sell on credit to attract external financial resources in order to fund their trade receivables.

- **Inventory**. The positive impact of inventory on the level of short-term debt is due both to the larger volume of business, which companies with higher inventory are able to engage in and the need to refinance that inventory. In order to reduce their short-term debts, companies need to optimise their inventory management, so that they would be less dependent on lenders and improve their profitability and capacity to generate internal financial resources.

- **Accounts receivable from customers and suppliers**. The identified positive impact of accounts receivable on the short-term indebtedness of SME-s facing liquidity problems is similar to the positive impact of the net sales revenue. The higher the volume of sales with deferred payment, the higher the short-term debts of companies for funding their trade receivables. That impact is further intensified by the serious issue of defaulted receivables in the country. What is more, financially distressed companies have greater difficulty in collecting their receivables since their customers are less motivated to be loyal payers due to the lower risk of discontinued deliveries and the difficulty, which companies face when taking legal actions against their debtors. Thus, small companies that are not able to exert credible pressure, increase their trade credit even when their cash flow is negative since they find it impossible to collect their receivables within the deadlines negotiated with their customers (Petersen и Rajan, 1997). It would therefore be advisable for such companies to reduce the volume of

their sales on credit in order to reduce the default risk. Companies need to make such decisions very carefully, though, since reducing the volume of sales on credit could result in lower sales revenue and give rise to further problems. This must also be taken into account during the risk management of commercial lending. The measures adopted to reduce the share of defaulted and uncollectible receivables should not result in losing customers or market share.

- **Financial assets**. Companies with higher volumes of financial assets are generally perceived as being more liquid, having easier access to external funding and being more solid. The positive impact of financial assets on companies' short-term debt may be accounted for with the fact that financial assets are an essential element of corporate risk-management strategies (Al-Amri, Al-Busaidi and Akguc, 2015, p. 102). Companies exposed to a higher risk hold higher volumes of cash, which is in line with the motive of cash holding as precaution.

The established positive impact of financial assets upon the short-term debt of financially distressed companies corresponds to the findings of a research conducted by Kling (2012) who proves that in the presence of uncertain cash flows, larger cash holdings reduce the default risk, thus improving access to short-term bank loans. He also clarifies that the higher the financial leverage is, the smaller the effect of cash holding on the default risk will be. The positive impact of cash assets on the short-term debt of financially distressed companies has also been established by the findings of the research conducted by Acharya, Davydenko and Strebulaev (2012), Quader and Abdullah (2016), etc. who prove that companies facing a higher default risk tend to hold more cash since they are aware that they are close to default.

- **Ratio of current assets to total assets.** The ratio of current assets to total assets is an indicator of the structure of assets and the liquidity of companies. Other things being equal, current assets are easier and faster to convert into liquid assets. Companies whose ratio between Cash flow from operating activity and Short-term liabilities is less than 1, and with a lower share of current assets, are more likely to experience serious liquidity problems, and, other things being equal, to bear higher default and failure risks. A higher share of fixed assets also indicates greater need of long-term

borrowed capital. Yet, companies exposed to a higher risk find it more difficult to borrow long-term capital. This is a possible explanation for the increasing short-term indebtedness of such companies. This inverse relationship may reflect the difficulty, which companies meet when trying to attract long-term funding due to the higher risk they bear and the practice of choosing short-term loans instead. Furthermore, SME-s' access to funding is as a rule more difficult due to information asymmetry and the smaller possibility to gain access to funding. In addition, other things being equal, the cost of financing also depends on the risk, which a company is exposed to, as well as the term of the loans, due to the different credit risk, which banks assume. It is therefore easier, as well as cheaper, for banks to use short-term loans. The effort to finance fixed assets through short-term loans, however, increases the risk, which companies bear in terms of refinancing that debt, the possibility of facing major liquidity problems and defaulting on their payments. The inverse relationship between current liabilities and the ratio of current assets to total assets is in line with Altman's (2000) observation that ordinarily, a firm experiencing consistent operating losses will have shrinking current assets in relation to total assets. Such companies are exposed to a higher default risk and need more external funding.

Conclusion

The findings of the research indicate that a substantial number of the small and medium-sized enterprises in the country find it difficult to cover their short-term debt with the cash flow from their operating activity, which is an indicator of financial distress. Companies which are not able to generate sufficient cash flow from their operation and do not have sufficient reserves to promptly cover their current liabilities can either choose to attract additional external funding or take on the risk of their creditors demanding that they announce their failure.

The multiple regression model was used to identify the major determinants of short-term indebtedness of financially distressed companies. The designed model shows the positive impact of the levels of net sales revenue, inventory, receivables from customers and suppliers and

financial assets and the negative impact of the ratio between current assets and total assets on the short-term debt of financially distressed SME-s.

Managers of financially distressed companies should therefore focus on improving the management of those factors in order to reduce the short-term risk of failure. Identifying the factors, which affect the level of short-term indebtedness of SME-s, renders it easier to predict and manage that debt and largely reduces the problems related to refinancing the debt of companies in critical moments.

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