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THEORETICAL SUBSTANTIATION OF MAIN CONSTITUENTS OF FINANCIAL POSITION OF AN ENTERPRISE: RELIABILITY, SOLVENCY AND FINANCIAL STABILITY

V.I. OSPISHCHEV

Kharkov State University of food technologies and trade, Ukraine

I.V. NAGORNAJA

Kharkov State University of food technologies and trade, Ukraine

Abstract

Financial system of Ukraine has rather complex and multilevel structure. It is stipulated by the fact that, on one hand, macroeconomic instability and, on the other hand, lack of experience of working in competitive environment led to arising and deepening of crisis at the national enterprises.

Due to the acute problem of insolvency of an economic entity the necessity of its forecasting and regulating on the national level, developing of the diagnostics system and preventing insolvency as well as forming strategy of recovering from crisis situation arose.

Indices of reliability, solvency, financial stability that characterizes relationships between counterparts were considered. Approaches to determining financial stability, characteristics of unstable financial position and main features of crisis financial position of an enterprise were offered.

Key Words: *insolvency, solvency, reliability, financial stability*

Jel Classification: G3, M00

Introduction

An essential constituent of Ukraine's transition to market relations is creating new business structures and privatization of enterprises. This transition stipulated evolution of relationships of property and types of economic entities in the direction of providing their diversity. The processes of market transformations attracted much attention to investigating theoretical and practical problems of further development increase in efficiency of functioning of enterprises of both public and private sectors of Ukraine's economy.

Analysis of financial position of an enterprise that reflects selection, evaluation and interpretation of financial, economic and other data influencing the process of making investment and financial decisions plays an important role in providing effective forms of managing national enterprises. Though the term "finances" itself has come through certain changes lately and has been considerably complicated financial analysts in the countries of developed market economy are traditionally engaged in calculation of ratios, financial analysis, making up trends and forecasts.

Presentation of the problem

Under conditions of market transformations any commercial organization, as a rule, faces the necessity of solving two main tasks. They are taking liability on current financial obligations and providing long-term financing in desired volumes. These tasks are formed as characteristics of financial position of an enterprise from the point of view of short-term and long-term prospects conformably.

From the point of view of short-term prospect financial position of an enterprise is evaluated by the indices of reliability and solvency that, in general, characterize whether it can make payments on short-term obligations to the counterparts in time and in full volume. Floating debt of an enterprise is paid off in different ways. Any assets of an enterprise including irreversible can serve as a direct security for such debt. Under condition of market relations reliability and solvency of enterprises are considered to be the most important condition of their economic activity. [Podderegin I, 2003]

At present time the problem of reliability is the most urgent. The necessity of evaluating reliability by the beginning of cooperation with an enterprise is stipulated by its purpose as a financial intermediary. Thus, in case of arising any problems in the activity of an enterprise it will automatically affect its customers and, therefore, the national economy as a whole. Reliability depends on a number of factors and they are individual for each entity. That is why definition of the term "reliability' as a final result requires deep investigation.

Reliability is defined as an ability to carry out undertaken obligations. Besides, there is a common opinion in economic literature that analytically this index is determined as a sum of a number of individual indices taken with different weighing ratios that show the degree of influence of a certain factor over final result.

Factors that determine reliability can be conditionally classified into external and internal. External factors are the ones stipulated by the influence of external environment that is the factors that determine the state of financial market, national and world economy, political climate in the country as well as force majeure circumstances. If the activity of external environment is quite stable, the final state of an enterprise is determined by internal factors. [Savitskaya G.V., 2003]

Internal factors are the ones stipulated by professional level of personnel and quality of management as well as the strategy of an enterprise, provision of its own capital, internal policy of an enterprise. Besides, internal factors of reliability of an enterprise include financial accounting, its quality, composition of shareholders, size and scope of activity, conservatism, transparency and public activity. [Savitskaya G.V., 2003]

Solving the tasks of stabilization of financial position of an enterprise requires availability of sources of financial resources, their rational allocation, efficient use during carrying out financial analysis, that evaluates financial stability n enterprise.

The term "financial stability" is rather wide and versatile that is why modern economic literature possesses interpretations of its essence, systematization and selection of estimated figures, characterizing it, that are complex and insufficiently propped up by arguments. The issues of limits and possibilities of the most efficient use of the whole system of methods of evaluation of financial stability in practical activity of an enterprise as well as algorithms and interpretation of indices, their criteria considering branch peculiarities of functioning are of great urgency.

Presentation of the basic material

There is an opinion that reliability of an enterprise depends directly on its size and scope of activity. It cannot be denied that large enterprises have vast opportunities relating to the quality of serving customers inside the country and abroad, they are usually well-capitalized and universal. But their activity is accompanied by the risks adequate to the volumes and types of operations. That is why the size of an enterprise can testify its stability.

From the point of view of its stability conservatism of an enterprise is quite important. If it carries out risky policy, then such policy can posses both economic and criminal risks. Conservatism of an enterprise carrying out its policy proves, at least, its intention to exist at the market for a long time.

Solvency is the ability of an enterprise to pay off advance commitments with available financial resources in proper time. [Lakhtionova L.A., 2002] When an enterprise has a good financial position, then it is constantly solvent. In case of bad financial position it is periodically or constantly insolvent.

It is important to pay attention to some features of such state. The main features of solvency are availability of funds in sufficient volume on settlement account and absence of state debt to the bank, budget, suppliers, workers and employees.

Solvency of an enterprise is rather closely bound up with liquidity of its assets. Some scientists even identify these two terms, but, nevertheless, these two terms are different. The term “liquidity” is more general because solvency depends on liquidity.

Liquidity of assets in turn is reciprocal quantity to balance liquidity that in due time converts assets into funds. It means the ability of assets to be converted into funds and the less time it requires the higher is liquidity of assets. Liquidity is less dynamic comparing to solvency. It is predetermined by the fact that during stabilizing its productive activity a certain structure of assets and sources of cash receipts are formed at the enterprise and, as a result, liquidity ratios remain unchanged or have slight deviation from the previous value, whereas financial position of an enterprise from the point of view of its solvency is characterized by sharp changes and depends on availability of funds, fulfillment of the plan of sales of products and timely receipt of payments from counterparts and so on.

Solvency of an enterprise is covered in case when less liquid assets are covered by relatively stable liabilities and short-term debt liabilities correspond to the most liquid part of assets. [Balabanov I.T. 2002]

It should be noted that insufficient liquidity arises when an enterprise is not able to use all the advantages of granting it discounts and profitable commercial possibilities. At this level insufficient liquidity means that an enterprise doesn’t have freedom of choice and it restricts its activity.

High level of insufficient liquidity leads two enterprise’s inability to pay off its current debts and commitments. It may result in its insolvency and even lead to bankruptcy.

For the owners of an enterprise insufficient liquidity may mean reduction of profitability, lost of control, partial or complete loss of capital investments. [Lakhtionova L.A., 2002] For creditors such state of liquidity of a borrower may mean delay in payment of interests and repayment of the main amount of the debt and partial or complete loss of the borrowed funds. State of liquidity and solvency of an enterprise also can influence relationships with suppliers and other partners because it effects whether an enterprise will pay for the raw materials in time and fulfill the terms of contracts.

Solvency of an enterprise has rather significant importance because it influences the activity of the whole organization. As it follows from the above mentioned it is necessary to pay more attention to economic content of the category, to conduct analysis of solvency, to reveal the reasons of its decline or growth.

It is important for economists and analysts to study thoroughly the level of solvency and at the same time insolvency. More often the main reasons of insolvency are:

- nonfulfillment of the plan of output and sales of products;
- high rate of taxation;
- nonobservance of regime of economy, surcharge in cost;
- diversion of resources into overnormative stock of raw materials, materials, finished products;
- nonfulfilment of a plan of profits and, as a result, shortage of own sources of self-financing. Here management of an enterprise has to organize the activity of an enterprise in such a way that not to allow such deviations. [Lakhtionova L.A., 2002]

Solvency of an organization is also an external feature of its financial stability. It is stipulated by the degree of availability of liquid assets supported by long-term sources. Analysis of solvency is required not only for an enterprise itself, but for its external partners and potential investors.

Having analyzed solvency of an enterprise according to corresponding indices specialists can come to a conclusion about solvency of an enterprise. In case of deterioration of its level the management of an enterprise should immediately undertake steps concerning improvement of its state. It can be achieved by raising volumes of incoming cash flows due to decreasing expenditures that relate to product cost or cover at the expense of profit that remains at the disposal of an enterprise.

The condition of viability of an enterprise and the basis of its development in the competitive market is stability. It is influenced by different factors, both internal and external: production of cheap goods and rendering services that are in demand; firm market position of an enterprise, high level of material and technical equipment of production and application of innovative technologies; establishment of economic ties with partners; rhythm of assets circulation; efficiency of economic and financial operations, slight degree of risk in the process of carrying out productive and financial activity and so on. Such diversity of factors influencing activity of an enterprise predetermines different aspects of its stability, in particular, general, price, financial and according to the factors influencing it – internal and external aspects.

Stable activity of an enterprise depends on both internal possibilities to use all available resources effectively and on external conditions including tax (credit, price) policy of the state and market situation. That is why information basis for analysis of financial state of an enterprise should be report data of an enterprise, some assigned economic parameters and external conditions of its activity that change and that should be taken into account during analytical evaluations and making managerial decisions.

In general, it can be stated that financial stability is a complex concept that is influenced by various financial and economic processes that is why they should be defined as the state of financial resources of an enterprise, efficiency of their allocation and use that assures development of production or other spheres of activity on the basis of increase of profits and assets while maintaining solvency and creditability.

A number of works of economists-scientists I Romane, T.Taffler, U.Viver, in the first place, and Ukrainian O.Kondratyev, O.Sugonyako, I.Demyanenko, V.Shkromida, partially M.Bilikorsky is devoted to problems of assuring financial stability of an enterprise of an enterprise, matters of quantitative characteristics of financial stability of an enterprise. Practise shows that the condition of viability of an enterprise and the basis of its development in the competitive market is stability.

Financial position can be stable, unstable (before crisis) and crisis. Ability of an enterprise to make payments in time, to finance its activity on expanded basis, to bear unforeseen circumstances and to maintain its solvency in unfavorable conditions proves its stable financial position and vice versa.

Financial stability of an enterprise is closely related to its solvency and its analysis gives an opportunity to determine financial possibilities of an enterprise for corresponding perspective.

According to the parameter of coverage of stocks and expenditures with own and borrowed funds there are such types of financial stability of an enterprise:

1. absolute financial stability (quite rare in practice) – when own circulating assets cover stocks and expenditures;
2. normally stable financial position – when stocks and expenditures are covered with own circulating assets and long-term loan sources;
3. unstable financial position – when stocks and expenditures are covered at the expense of own circulating assets, long-term loan sources and short-term credits and loans, that is at the expense of all main sources of formation of stocks and expenditures;
4. crisis financial position – when stocks and expenditures are not covered with the sources of their formation and an enterprise is on the verge of bankruptcy. [Zayukova M.S., 2004]

An enterprise is considered to be financially stable, when it is able to cover stocks and expenses at the expense of its own assets, not to allow unjustified credit indebtedness, to pay off own debts timely.

It is expedient to carry out evaluation of financial stability of an enterprise step-by-step on the basis of complex of indices.

Efficiency of activity of an enterprise will mainly depend on how fast and right it will orient in the whirl of market relations, how accurately and faultlessly it will choose its business partners. Analysis of financial position of an enterprise becomes especially important and necessary.

External stability relatively economic entity, in turn, should be determined on the basis of stability of economic environment within which it s operations are carried out. It is achieved by corresponding macroeconomic regulation of market economy.

It is possible to mark out so called hereditable stability, that is determined by availability of certain safety margin, achieved by an enterprise for the period of its previous activity and that protects from influence of unfavorable destabilizing factors. [Zayukova M.S., 2004]

It is obvious that general stability of an enterprise can be assured only on condition of stable selling (timely payment for supplied goods, rendered services, performed work) and obtaining sufficient in volume receipts to meet commitments before the budget, to pay suppliers, creditors, employees and so on. At the same time for development of an enterprise it is necessary that after effecting all payments and commitments it will have such margin of profit that would give an opportunity to develop production and to put it into competitive level, to carry out social and cultural programs for its employees, to assure strengthening incentives for their highly effective labor. In other words, general stability of an enterprise stipulates, first of all, such movement of its cash flows that provides constant excess of receipts over expenses.

It is precisely such situation that expresses the essence of financial stability that is the main component (condition) of general stability of an enterprise. Financial stability reflects such state of its financial resources and such degree of its use, when an enterprise freely manœvring by funds is able to assure continuous process of production and selling of goods as well as expenditures on its expansion and renovation.

Conclusions

Summarizing the above mentioned it can be stated that financial stability is a complex concept that is influenced by various financial and economic processes that is why they should be defined as the state of financial resources of an enterprise, efficiency of their allocation and use that assures development of production or other spheres of activity on the basis of increase of profits and assets while maintaining solvency and creditability.

Hence, an important matter of developing such methodology of evaluation that would give a clear idea of the available financial state of an enterprise, environment where it functions, require minimum public information, thoroughly deal with activity of an enterprise and could be the basis for elaborating recommendations concerning following increase of its financial stability arises nowadays.

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