Concepts, strategies and mechanisms of economic systems management in the context of modern world challenges

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SCIENTIFIC APPROACH TRANSFORMATION FOR LIQUIDITY AND SOLVENCY ASSESSMENT

The elimination of bankrupt business structures from the market is a prerequisite for effective functioning of the market mechanism. However, the prevention of bankruptcy and security of long-term prosperity of these structures is a much more complicated and important task.

The mechanism formation and the bankruptcy procedures application to many companies involve an objective assessment of their financial state and are a priority of companies themselves as well as of their counterparties, investors, creditors and government agencies. The most important characteristics of financial insolvency assessing of any economic entity are the ratios of solvency and liquidity.

Unfortunately, there is no unambiguity in understanding the essence and, consequently, the assessment system for categories such as "venture liquidity" and "venture solvency" in the existing domestic economic theory and practice.

First and foremost, it should be noted that the concepts of liquidity and solvency are closely interrelated but not identical. It is necessary to mention that the concept for "liquidity" is referred to both the specific types of assets and to all of them as a whole ("balance sheet liquidity", "investment liquidity") and a company as a subject of financial relations.

“Liquidity of an asset is meant as its ability to be transformed into money, and a degree of liquidity is determined by the length of a time period during which this transformation can be carried out. The shorter the period the higher is the liquidity of this type of assets” [1]. The meaning of the category of liquidity of assets is determined by the existence of an asset that has a special property – the absolute

liquidity, i.e. the absolute exchange capacity. Such assets are funds.

Liquidity can be characterized on both sides. First, it is the inverse of time it takes to sell an asset quickly at a certain price. Secondly, it is an amount of money that can be obtained for it. Of course, they are interconnected as it takes more time to get a higher price for a product (asset) and in order to speed the implementation process up it is necessary to reduce the price [2].

As for the concepts of "balance sheet liquidity" and "venture liquidity" we must admit that many authors do not see much difference in them. In general, the balance sheet liquidity is characterized by the actual asset status and its ratio to the current liabilities. It is defined by some authors as a degree of coverage of company's liabilities by its assets so the term of conversion into money corresponds to a maturity date [3-5].

Doctor of Economics V. Kovalev, a specialist in financial management, emphasizes that the main indication of the company's liquidity is a formal excess of current assets (in value) over short-term liabilities. "Speaking of the venture liquidity we mean the availability of working capital in an amount theoretically sufficient to repay short-term liabilities even if the maturity date of the contract is expired. As you can see the main difference in determining the balance sheet liquidity and the venture liquidity in this case is to take into account the time factor. If in determining the balance sheet liquidity the ratio of different types of liabilities in terms of their maturity date and a need to be repaid with the relevant groups of assets in terms of their transformation into the most liquid form (cash) are emphasized then in determining the venture liquidity all current assets and current liabilities are considered in general. However we believe that the company's ability to meet current financial liabilities is determined not only by the quantitative balance of assets and liabilities but also by their time balance.

The qualitative difference between the concepts of "asset liquidity" and "venture liquidity" is that the latter characteristic feature synthesizes not only the asset properties but also in terms of attracted for their formation financial resources while the asset liquidity is determined regardless of the balance sheet liability [6].

On the one hand, the venture liquidity depends on the specified demand for payments, on the other, on the ability to pay. There is a

point of view that could be found in some domestic publications that the company is called liquid when it is able to meet its obligations for creditors, budget, insurance companies, landlords, employees, suppliers, etc., besides these obligations should be committed on time. If the ability to pay at this time is greater than the payment obligation then such a venture is considered to be as liquid [7].

However, these regulations, in our opinion, do not maintain the differences between the concepts for "balance sheet liquidity" and "venture liquidity". Today there is adopted in the Western countries the practice of a broad interpretation for liquidity which reflects not only the current situation but also liquidity disclosure that may arise in the future in connection with future payments and decisions. According to this interpretation an venture is called liquid (planned) if its payment obligations at each point of the planning period meet the deadlines set in the contract [8,9].

In this regard let’s consider how the essence of the venture liquidity concept is interpreted in the classic textbook "Economics Of A Venture" edited by FK Bea, E. Dichtl, M. Schweitzer. According to the authors: "Based on the concept of solvency, it becomes clear that liquidity (illiquidity) depends on the evidence of a claim for a company, on the one hand, and the availability of resources for payment, on the other. The liquidity property can be assessed by the ratio of payment resources for existing requirements "[10]. In this case, payment resources mean the ability of a venture to provide means for payment (e.g. funds). "If the payment resources of a venture are greater than payment obligations at any given time, the venture is considered to be liquid" [ibid].

Further on, the authors of the textbook emphasize that this definition, although, typical does not take into account the following important points: first, the aspect of venture liquidity development in future; secondly, funds are not the only liquidity medium. The venture payment resources can be any goods suitable for exchange. In this case, the venture liquidity can be assessed not only by the total value of a certain range of assets but (what is more importantly) as its cumulative value in the form of a property complex. It is further specified that if the balance sheet liquidity is provided by means of repayment from internal sources then the venture liquidity is provided by its ability to attract borrowed funds from abroad.

Thus, the main features of the balance sheet liquidity are: a) the presence of current liabilities; b) the availability of means of payment in various forms; c) the determination of their conformity at any given time. And the venture liquidity is not only determined by its balance sheet liquidity but also by its business image in the world and by its investment appeal.

In this regard we adhere to the following definitions of the balance sheet liquidity and the venture liquidity. The balance sheet liquidity is the ability of a business entity to turn assets into cash and repay its payment obligations at any time, or rather it is a degree of a discharge of the venture liabilities by its assets which period of conversion into cash is relevant to the repayment period. The venture liquidity is its ability to be responsible for a range of assets either individually or in complex with its payment obligations at any time during the current and planning periods in accordance with a treaty concluded wherein it can be provided by both an increase in assets and an increase in liabilities.

This definition of the venture liquidity makes it possible to distinguish it from the concept of the venture solvency.

According to M.N. Kreinina: "Solvency means that a company has a financial capacity to regularly and timely repay its debts. Such opportunities are determined in the end by the availability of venture funds"[11].

Unfortunately, in some publications the concepts of venture liquidity and venture solvency are not differentiated [4; 6] and if they are distinguished then their definition implies a similar meaning which in our opinion narrows and distorts the possibilities of their evaluation and hence reduces the ability to make timely decisions to overcome the venture insolvency.

The classics of analytical science A.D. Sheremet and R.S. Saifulin distinguish the current and long-term liquidity understanding current liquidity as a ratio of the most liquid assets (funds and short-term investments) and assets (receivables) that are quickly implemented by short-term liabilities. The comparison of slow-moving assets with the long-term and the medium-term liabilities reflects in their opinion the promising liquidity. In this case the current liquidity is associated by them with the solvency for a near future and the prospective liquidity is a forecast of solvency [12].

We agree with the opinion of a majority of authors [1; 3] that despite having the affinity of these concepts there are certain differences between them. The concept of the venture liquidity is more capacious than the concept of the venture solvency. "Solvency means that the company has funds and their equivalents are sufficient to settle accounts payable which requires an immediate repayment. Thus, the main features of solvency are: a) the availability of sufficient funds on the checking account; b) no overdue of accounts payable" [1].

The venture liquidity largely determines its solvency provided that the current assets include highly liquid elements. At the same time a company having a high level of inventories that do not meet the market requirements and receivables of insolvent customers may be characterized by high liquidity ratios but be virtually insolvent. Similarly, the availability of funds in a company sufficient to make current payments today does not guarantee its solvency in the long run i.e. its liquidity.

The authors such as A.A. Mazaraki, L.A. Ligonenko [13; 14] interpret the notion of venture solvency somewhat more broad. Solvency is determined by a consistency of income and venture expenses which in their turn provide (or do not provide) opportunities for permanent or periodic financing of activities and implementation of commitments undertaken.

The characteristic features of solvency are the availability of sufficient funds to meet their obligations and finance their current activities. That is a company is solvent not only when it has the ability to meet its external obligations but also when it has the ability to finance its current activities. In our opinion rectification on current activities financing is inadvisable due to the fact that current commitment meeting is nothing more than the financial security of the current activities.

M.N. Kreinin notes a slightly different nature of a capacity to pay. She writes that the availability of a certain amount of funds for this or that date is not yet a criterion for the venture solvency assessment. Quite a different thing is a change in a cash flow pattern for a certain period and reasons that caused this change. In other words, it is necessary to determine which activities and which elements of assets and liabilities contributed to an increase or a decrease in funds and to

what extent did it happen. Having determined this issue we can answer the question which direction assets and liabilities should be changed to for an increase in the amount of funds [11]. This point of view we cannot but agree with and it is especially important in the process of the venture solvency regulation.

If the venture liquidity state is determined by its capital flows then it is its solvency that depends on a capital flow. The capital flows occur in parallel, and they are in a constant correlation. Maximizing the amount of money a company has is not an end in itself. It should be sufficient to cover current liabilities. With a standard turnover cash it is constantly transformed into other elements of assets and liabilities that are necessary for the venture operation.

Funds can be considered as a resource and as an outcome of a venture activity. Funds are a tangible form of financial resources of a venture. Their presence at the time of the venture state assessment characterizes the amount of available financial resources that can be invested in a new business cycle or investment activity and determines a current venture solvency and a liquidity of its assets [14].

Solvency is formed under influence of all types of a venture economic activity though its quantitative representation it finds in cash flows.

Most authors associate the concept for solvency with a company's ability to pay off its short-term liabilities though there are some different points of view when solvency is associated with the ability to pay off long-term liabilities and the ability to pay off short-term liabilities which is called – liquidity [15].

In the literature of economics and finance there is a trend which the authors do not see any difference in between such characteristics of a venture as its solvency and financial stability. Determining solvency as "... the adequacy of the liquid assets to repay all of its short-term liabilities to creditors at any time" they define financial stability as "the guaranteed solvency free from contingencies of market conditions and the behavior of business partners". In which case "the main "symptom" of stability is the availability of net liquid assets that are considered as the difference between all liquid assets and short-term liabilities at one time or another" [16]. In the

translated publication “Fundamentals of Financial Management” by J. K. Van Horn while characterizing a financial state of a venture we find some groups of indicators for assessing the liquidity and solvency but there is no such thing as financial stability. Solvency is defined as a long-term liquidity i.e. as an ability of a company to meet its long-term liabilities. But in this case we are dealing with an inaccuracy of translation – the word “debt” is translated as solvency though its literal translation means “credit” or “liability” and the word “solvency” in English means “paying capacity” or “paying ability”. The ratio of the total debt (or the loan capital) to the equity characterizes its long-term solvency which many authors call the financial stability of a venture. Thus V. V. Kovalev points out that financial stability is associated with the whole financial structure of a venture and the degree of its dependence on creditors and investors and characterizes the stability of operation in terms of a long-term perspective [1].

If to put it more simply the assets and liabilities balance that is involved in the assessment of the venture’s financial performance can be represented as follows:

Solvency <Liquidity <Stability

In connection with the above said we stick to the point that solvency is the ability of a venture to meet its short-term liabilities secured by the available money and its equivalents.

Thus, the main differences between the venture liquidity and solvency are as follows:

– the venture liquidity is determined by a size and amount of current assets and solvency is determined by the currently available assets in a certain (monetary, highly liquid) form;

– the venture liquidity implies the ratio of all current assets and their groups with current liabilities, and solvency implies the highly liquid assets with the most urgent liabilities;

– solvency is more dynamic than liquidity;

– solvency characterizes a current state of a venture and liquidity characterizes not only the current state but also the promising one;

– the venture liquidity is determined by financial flows and solvency is determined by cash flows.

To be brief in our opinion liquidity differs from solvency in the sense the means of exchange differ from the means of payment.

The diversity of the content, the variety of manifestations and consequences of liquidity and solvency phenomena for a venture determine aneed to distinguish between their types and individual characteristics which should be taken into account in the process of their assessment and management.

In the literature of economics there are the following types of liquidity: commodity or commodity-economic liquidity; loan or liquidity on loans; future or perspective liquidity; and expected or anticipated liquidity. This division is due, on the one hand, to the source of liquidity (assets or liabilities), and on the other – to the period of liquidity assessment over time (current or reporting date and future dates).

Under commodity (commodity-economic) liquidity we mean the venture liquidity based on the ability of goods and services that specify its production needs with varying degrees of intensity for exchange. This type of liquidity is provided by the appropriate size and consistency of venture assets for the asset valuation date. It depends on the following factors:

- technical and underwriting characteristics of goods;
- a period of time necessary to find a buyer and a final point of sale of goods;
- commercial costs of transactions with the buyer;
- market conditions.

Borrowed liquidity or liquidity on loans is the ability of a venture to obtain a loan (to attract liquid funds) secured by available assets. It is provided with the growth of liabilities and can be assessed at any moment.

Liquidity guaranteed by obtaining a loan has some advantages:

– the mortgaged property is not alienated but is used by its owner and often remains at his disposal;

– the risk of losses from assets sale with a low liquidity level is reduced as the company is freed from a need for the rapid implementation of this process;

– there is an opportunity to get extra money after repaying a loan and selling goods provided as collateral in case of the favorable financial and market conditions.

At the same time along with the advantages this kind of liquidity guarantee has it can also have some negative effects under

favourable conditions of loans.

The venture efficiency assessment based only on a state of property, assets liquidity, and also on its ability to be collateral at the moment is one-sided. It is acceptable under circumstances when a company is being liquidated and will operate no longer. If the business is operating then possible receipts and payments should be considered.

In this regard there is long-term, or future liquidity which is provided by possible revenues and payments resulting from resolutions of current and future periods. This type of liquidity involves a continuous dynamic operation of a venture during a planning (future) period.

Expected or anticipated liquidity is the ability of an enterprise to obtain loans secured by the future receipts. In this case a bank provides a loan for a company not being secured with its goods or services i.e. on trust.

If the first two types of liquidity can be estimated on the basis of a balance sheet and other forms of financial reporting then the last two can be estimated on the basis of a financial plan and forecast estimates.

Thus, the synthesis of the main characteristics for the "asset liquidity", "balance sheet liquidity", "venture liquidity" and "venture solvency" concepts has allowed to distinguish and clarify such parameters of a venture as its liquidity and solvency. This made it possible to identify clearly the venture liquidity types with the help of such sources as security and evaluation periods.

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