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CONTEMPORARY VIEWS ON THE ESSENCE OF COMPANY'S SOLVENCY ANALYSIS

The article presents the critical analysis and the systematization of the existing approaches to the essence of the notion "company's solvency". The summarizing system of company's solvency evaluating indices is offered. It allows evaluating solvency on 3 levels – instant, current and prospective.

Keywords: *solvency; liquidity; financial stability; financial state analysis; system of indices.*

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СУЧАСНІ ПОГЛЯДИ НА СУТНІСТЬ АНАЛІЗУ ПЛАТОСПРОМОЖНОСТІ ПІДПРИЄМСТВА

У статті представлено критичний аналіз і систематизацію існуючих підходів до сутності поняття «платоспроможність підприємства». Запропоновано узагальнюючу систему показників оцінювання платоспроможності підприємства. За її допомогою платоспроможність можна оцінити на 3 рівнях – постійному, чинному та перспективному.

Ключові слова: *платоспроможність, ліквідність, фінансова стабільність, аналіз фінансового стану, система показників.*

Рис. 1. Табл. 3. Літ. 18.

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СОВРЕМЕННЫЕ ВЗГЛЯДЫ НА СУЩНОСТЬ АНАЛИЗА ПЛАТЕЖЕСПОСОБНОСТИ ПРЕДПРИЯТИЯ

В статье представлен критический анализ и систематизация существующих подходов к сущности понятия «платежеспособность предприятия». Предложена обобщающая система показателей оценки платежеспособности предприятия. С ее помощью платежеспособность можно оценить на 3 уровнях – постоянном, текущем и перспективном.

Ключевые слова: *платежеспособность, ликвидность, финансовая стабильность, анализ финансового состояния, система показателей.*

Introduction. At the present stage of the world economy's development, which is accompanied by strengthening of global financial crisis effects, success of company depends heavily on the level of its current and perspective solvency. In such conditions the relevance of theoretical and practical foundations for company's solvency providing and the management system improvement increases. Appropriate tools and instruments of administrative decisions become especially important.

Recent researches and publications overview. The development of market transformations in Ukraine is connected with significant number of publications dedicated to the problem aspects of company's solvency management, particularly its analysis and estimation. However, the main problem of Ukrainian companies' effective functioning is the absence of theoretical and methodical argumentation and developed practice of complex approach in relation to solvency management. Except indices calculation following typical methods and their interpretation, it must enable guidance to discover and explain formed trends, to determine reserves for solvency strengthening, to understand economic mechanism of administrative actions intercommunication and take into consideration the consequences of their implementation, to provide sufficient solvency in short-term and long-term perspectives.

Problem definition. The aim of the research is the generalization and critical analysis of the present theoretical and methodical developments related to the essence of the notion "company's solvency", its classifications and place in a company's financial state formation, propositions in its improvement according to the requirements of complex solvency evaluation of market participants in the short and long term.

Results of the research. There are various approaches to the economic content of solvency determination and its analysis described in Ukrainian and foreign theories of financial analysis. The majority of all misunderstandings, disagreements and even opposite statements appear around this feature of a company's financial state along with liquidity and financial stability.

Analyzing the definitions of company's liquidity and solvency, presented in economic literature (Table 1), it is possible to draw conclusion that there is no difference between these 2 notions in many publications, the definitions are almost identical.

Concerning the substantial differences in interpretations presented in Table 1 we can select such approaches to solvency determination:

- short-term oriented – solvency is considered exceptionally from the viewpoint of ability to repay urgent and current liabilities. In this case, as a rule, authors determine it as an important premise of company's financial stability, which, unlike solvency, is related to company's ability to be responsible for long-term liabilities;

- system – solvency is treated as an opportunity to perform the payment obligations in general, regardless their term, due to the already formed assets within a given period, i.e. it is evaluated according to a certain date. At the same time, as a rule, financial stability is interpreted as the key condition for a company's constant solvency.

M.M. Kreynina (2001) gives the typical definition for the first approach: "Solvency is the assets availability, sufficient to repay all short-term debt liabilities with the uninterrupted production and sales process" [9]. Unlike other definitions from this group (V.V. Kovalyov (2001), L.A. Lakhtionova (2004), V.O. Metz (1999)), this one emphasizes the necessity of securing the opportunity for constant production activity in the process of solvency management. However, it is necessary to notice that this important condition of company's solvency is very often ignored in the standard methods of financial state evaluation, recommended for usage by Ukrainian companies. As a result it leads to understatement of the relevant normative indices values.

Despite the prevalence of the "short-term oriented" approach we can't agree with the statement that solvency deals only with short-term liabilities: long-term ones anyway should be repaid in time. Certainly, company needs assets for a new production cycle, but, except the provided short-term liabilities, it also should have certain reserve of resources for the long-term liabilities payment, the time of repayment for which will come in the following accounting period.

Also controversial, in our view, are the opinions of those scientists who argue like E. Utkin (1997), that solvency means company's ability to repay fully and timely the

Table 1. **Definitions review of company's solvency, liquidity and financial stability***

Definition: Company's solvency	Definition: Company's liquidity	Definition: Company's financial stability	Authors, source
...ability ...to fulfill payment obligations completely and in time, as a consequence of commercial, credit and other monetary operations	...ability ...to fulfill debt obligations in time; depends on the debt size and liquid funds volume	stability, constancy, independency of the losses risk	А.Н. Азрилиян (A.N. Azriliyan, 2004) [2, *428*, *665*]
...money and its equivalents present in a company, sufficient to cover accounts payable, which requires immediate redemption. ...money presence... on the account; ...absence of the delayed ... debts	availability of circulating assets in a volume which is theoretically sufficient to repay short-term liabilities ...formal exceeding (in cost) of circulating assets over short-term liabilities	...problem of estimation the company's ability to meet its long-term liabilities – this is the essence of company's financial stability assessment	В.В. Ковальов (V.V. Kovalyov, 2001) [7, *19*]
...acts as the external display of financial stability, the essence of which is circulating assets provision by the long-term sources	–	...certain state of company's accounts, which guarantees its solvency...	А.Д. Шеремет (A.D. Sheremet, 2001) [*18*, *147*, *162*]
...ability ...to pay for long-term liabilities completely and in time	...the company's ability to pay for its short-term liabilities in time and without delay	...process of company's counteracting the negative external circumstances, its reaction to external irritation, which causes the imbalance	Е.А. Уткін (E.A. Utkin, 1997) [16, *207*, *216*]
...ability to pay for short-term liabilities completely and in time	...ability to convert assets into cash to cover all necessary payments when time comes	...is connected with the degree of dependence on creditors and investors and is characterized by ratio of own and borrowed assets	В.О. Мец (V.O. Metz, 1999) [11, *82*, *94*]
...is determined by company's ability to repay quickly its short-term liabilities	...ability to convert circulating assets into payment tools	...is achieved at steady surplus, free cash maneuvering and stable economic growth	Є.В. Мних (E.V Mnykh, 2005) [12, *165*, *170*]
...company's ability to liquidate the urgent obligations using present money resources	...ability and company's speed in transformation of its assets into cash to meet the required payments when time comes		Л.А. Лахтіонова (L.A Lahtionova, 2004) [10, *176*, *179*, *196*]
...displays company's ability to respond (to pay) to its liabilities in a specific period of time	...ability to convert assets into cash for its short-term liabilities repayment	...safely guaranteed solvency in ordinary conditions of management and under casual changes at the market	Т.Д. Костенко (T.D. Kostenko, 2005) [*8*, *272*, *294*]
...assets avalaibilty in a company to repay its debt obligations completely and in time, which comes from credit and other monetary operations, thus it's the company's ability to fulfill its obligations. It is an external assessment of its financial stability by the level of circulating assets provided by the long-term sources	...company's ability to convert its assets into cash without loss of its market value to cover all necessary payments in time and the speed of this transformation	...such state of its financial resources, their division and usage, which provides company's development on the basis of income and capital growth while maintaining the solvency and creditworthiness at the acceptable level of risk	Н.В. Тарасенко (N.V Tarasenko, 2006) [15, *260*, *262*]

* authors' compilation.

long-term liabilities. We suppose one shouldn't concentrate on the long-term liabilities only while defining solvency, because, as a rule, current payments prevail in the general amount of payment obligations in the short-term period.

For the second selected approach the combination of 2 previously examined viewpoints is inherent. The most typical is the definition by A.D. Sheremet (2001): "...company's solvency is determined as the ability to cover all company's liabilities (short- and long-term) by all assets" [18]. In our opinion, this definition is more accurate compared to others, as it includes all types of liabilities and specifies the purpose (end-point). However, it can't be recognized as complete, because it doesn't take into consideration the necessity for reproductive process continuity.

The performed analysis allows us to define the problem for consideration: solvency is the ability of a company to perform its short-term liabilities and provide fulfillment of long-term liabilities, in the part which will become short-term in the following accounting period, in complete volume and within a certain term using the available assets of the monetary fund on condition that productive activity is constant.

The given definition does not contradict the world practice of company's solvency interpretation. It should be mentioned that the majority of foreign scientists indicate that solvent company is the one which has "positive circulating assets", i.e. available net circulating (working) capital. Taking into account the balance connection of company's assets and liabilities the formation of payment reserve for the part of long-term liabilities, which will turn into shot-term in the following account period, and providing the continual production cycle is possible only if the company's cost of current assets in a certain period of time excels the amount of short-term liabilities. This idea is supported by the scientists belonging to Ukrainian and Russian economical schools regardless the inherent approach to interpretation of the notion in this research. For example, L.D. Sheremet (2001), E.V. Mnykh (2005), N.V. Tarasenko (2006) determine net current assets as the fundamental absolute index of company's solvency.

On the other hand, Y. Waarst and P. Reventlow (1994) determine company's solvency as the "ability to stand losses". We suppose that this is quite capacious, despite its simplicity, point of view in relation to the given notion. We consider that the usage of the word "losses" here is connected with the corresponding point of view on the payments, which are connected with the liabilities' paying off. Certain connection with the definition given by us can be traced in it: the necessity of having some potential or assets reserve to pay for possible losses caused by long-term withdrawal of capital, demands advanced by creditors concerning immediate liabilities' paying off.

As it has been mentioned earlier, the difference in the specified approaches to solvency interpretation lies not only in the level of company's liabilities coverage, but also in the interpretation chosen by an author concerning the connection between solvency and financial stability.

"Short-term oriented" approach in the majority of cases presupposes investigation of that connection according to the "factor – result" scheme with the observation of financial stability in the role of the latter, and the "system" approach, on the contrary, determines solvency as the result of company's stable functioning. We think that between solvency and financial stability, which under conditions of market economy are the most important features of financial state of a company's complex economic system, there exists complicated relationship of cause-effect nature, which doesn't allow determining their definite place in the scheme "factor – result". The specific results of the solution of the given task depends on the horizon of solvency evaluation, i.e. on the type of solvency (Table 2).

Table 2. **Types of company's solvency***

Type of solvency	Range of evaluation	Peculiarities of evaluation technique	Character of connection with financial stability
Instant	3–5 days (period of cash and cash equivalents liquidity)	Estimates the level of provision for the instant obligations by cash and cash equivalents	Is the basis for financial stability formation
Current	Short-term period	Estimates the level of provision for the short-term liabilities by circulating assets taking into account the expected net cash flow	Is the basis for the financial stability formation
Perspective	Medium-term period	Estimates the level of provision for the liabilities (short-term and some of long-term) by circulating assets taking into account the expected net cash flow	Is the evidence of financial stability

* authors' own work.

Probability of solvency in time is a process directly related to strengthening of company's financial stability. Stability of financial state depends on results of production, commercial, financial and investment activity of a company, and the stable financial state, in turn, has positive influence on its operation. Thus, if current solvency is the external display of company's financial state, then financial stability is its internal side, which provides stable solvency in the long term, which is based on the balance of assets and liabilities, incomes and expenses, positive and negative money flows.

The group of authors headed by A.M. Podderiogin (2005) remarks that "company's financial stability is closely connected with its perspective solvency" [17]. Such approach is typical for the majority of guidelines used in Ukraine, because one of the indices groups in them is known as "Indices of financial stability (solvency) evaluation".

Each of the determined solvency types corresponds with certain insolvency type. These types are differentiated depending on the extent of crisis effects, one of the evidences of which is the required assets for the liabilities repayment level. Thus, normative provision of solvency analysis in Ukrainian companies presupposes the following classification of companies' insolvency:

- current insolvency – the financial state of a company when at a certain moment, due to the circumstances, accidental concentration of the amount of its available funds and high liquid assets temporarily is not enough for the current debt repayment. According to the legislative definition it is known as incapability of an enterprise to fulfill its accounts payable after their fulfillment term, including wages, and also obligations on taxes and charges (obligatory payments) cover through the solvency renewal;
- critical insolvency – corresponds to the potential bankruptcy;
- supercritical insolvency – when the fulfillment of creditor's requirements, accepted by court of justice, is possible only through the liquidation process;
- fictitious insolvency.

We think that first 3 mentioned types of insolvency are the display of negative qualitative evaluation of solvency types, determined by us: current insolvency – instant solvency; critical insolvency – current solvency; supercritical insolvency – perspective solvency.

However, in addition to that normative provision of solvency analysis for Ukrainian companies it is recommended to provide the profound studying, in particular within the detection of short-term liabilities coverage level by current assets. Considering the necessity of their availability to cover the part of long-term liabilities and company's activity continuation during the following periods the dynamics of profitability indices is foreseen in further study.

The connection between company's solvency and liquidity is significant for theoretical and practical investigation. Some specialists identify solvency with liquidity, while others emphasize their difference. However, some scientists point out that solvency is broader than liquidity [5], and others, on the contrary, state that liquidity is a more comprehensive concept [15]. We share the point of view of those authors that stress the principle difference, though still correlate the notions of "solvency" and "liquidity".

The term "liquidity" means the ability of a company to transform its assets into cash in order to cover its debt obligations [13]. It should be remarked that this is not ability to pay off or pay in time, to fulfill payments for liabilities, but the competence to transform assets into money in order to perform payments. In addition to that, liquidity of a company presupposes the availability of assets, first of all current ones, in volume which is theoretically enough to cover the short-term liabilities, even if it means the violation of terms, indicated in a contract.

If a company is acknowledged to be liquid then additional conditions for its staying as a market participant are not advanced. Considering that, effective financial management presupposes company's liquidity at the level determined by priorities of ensuring its current and perspective solvency. At the same time, liquidity is the determinative factor for company's solvency formation.

Liquidity is less dynamic in comparison with solvency, since stabilization of business activity forms relatively invariable balance structure, which is determined, first of all, by its sectoral belonging. Under these conditions the coverage degree of liabilities by its assets, the transformation period of which corresponds to the liabilities payment period, also stabilizes and inconsiderably changes in time. At the same time company's solvency, which is considerably determined by intensity of cash income and expense, and, respectively, depends on the quality of contracts and payment discipline of both company itself and its counterparties, is not static. Considering that, we can agree with G.V. Savytska (2007) [14] that under normal conditions solvency estimation should be done on the basis of studying the sources of cash income and expense in the short-term and long-term perspective and company's ability to provide stable surplus.

It should be mentioned that the economists use different methods of solvency analysis, which differ in the quantity of indices and trends. Russian and Ukrainian scientists evaluate solvency according to a number of indices, which often duplicate information, presuppose profound study of the separate narrow sphere of a company's activity.

A brief review of the positions of Ukrainian scientists and the methods of the analysis of company's solvency proves that this problem is not solved yet. All of them have common drawbacks:

- exceptionally static character, which limits their analytic value and objectivity of the analysis results;
- they do not take into consideration the quality of a company's current assets management, which is the key factor of solvency formation and presupposes investigation of convertibility indices, duration of company's operational and financial cycles.

Differences in methodical approaches complicate calculations and lead to difficulties in determination of a company's financial position compared to its competitors. That's why it is necessary to determine the system of indices, which are able to provide the opportunity of making proper administrative decisions.

We think that method of company's solvency analysis should be systemic, but depending on the purpose of application it is possible to perform analysis in the shorten variant (checking the potential contractor's solvency, one of the solvency types evaluation), however, in order to control company's solvency it is necessary to perform complete analysis. The general model of company's solvency analysis, which includes the approach to its essence interpretation, mentioned above, is shown on the Figure 1.

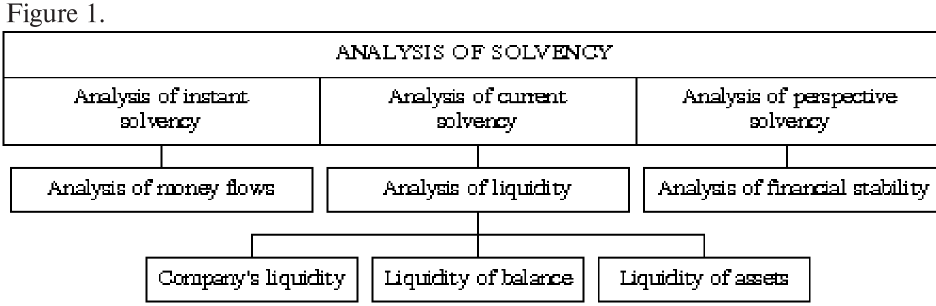

Figure 1. **Scheme of company's solvency analysis,** *authors'*

For a more detailed company's solvency analysis the system of indices is offered (Table 3). To our mind, it allows an extended analysis of company's solvency, to find causes for its change in time and to take promptly appropriate measures for financial state improvement.

The indices of solvency analysis are grouped in the table according to solvency types (instant, current, perspective) and divided according to their importance in getting of objective solvency rating into 2 groups – main and auxiliary. They are also divided according to solvency characteristics, obtained on their basis, into indices of static and dynamic rating. The given system of indices is not comprehensive; it contains only basic indices, with the help of which it is possible to analyze thoroughly company's solvency.

Thus, the effective management of company's solvency requires special analysis method application of the given component of financial state, which makes it possible depending on the tasks to perform estimation of company's ability to cover its liabilities both in general and for separate solvency types, given in certain moment and in dynamics, in general in the course of certain time.

Table 3. **System of company's solvency indices,** *authors'*

Instant solvency		Current solvency		Perspective solvency	
Main	Auxiliary	Main	Auxiliary	Main	Auxiliary
Static characteristics of solvency					
Level of current pay readiness		Clear current assets	Coefficient of guaranteed solvency	Beaver's coefficient	Coefficient of financial independence
Coefficient of money solvency		Liquidity ratio	Coefficient of own money security	Coefficient of manoeuvrability of own capital	Correlation of liabilities and own capital
		Urgent solvency ratio		General solvency ratio	Correlation of current and irreversible assets
		Absolute solvency ratio			
Dynamic characteristics of solvency					
Amount of clear cash flow	Coefficient of effectiveness of cash flow	Solvency ratio of renewal (loss)		Duration of financial cycle	Circulation period of company's assets
Liquidity ratio of cash flow				Correlation coefficient of circulation period of debtor's and creditor's debt	Duration of production cycle
Debt service ratio					Duration of operation cycle

Conclusions. The presented results of the existing views investigation allow us to select such main statements, which characterize "company's solvency" as an economic category.

Firstly, solvency is a complex and multifactor notion, which, on the one hand, is conditioned by economic environment of a company and the results of its functioning, and, on the other hand, determines them.

Secondly, solvency should not be identified only with the possibility of debts returning, it presupposes possibility to pay for all needs, which are necessary for the process of business activity. In addition to that, in determination of company's solvency the term of liabilities is not of great importance.

Thirdly, the solvency state is conditioned by the available volume of money assets, but is not limited by it. It is treated not only as the ability of urgent paying off the liabilities at the moment of evaluation by means of available money, but also as the ability of a company to provide production of cash flows, which according to amount and terms correspond to liabilities and pay needs of a company. Thus, the fulfillment of payment obligations and needs can be performed by means of both own and loan assets in case if company has potential abilities of servicing and returning the loan assets.

Fourthly, solvency is thought to be not static characteristic. The greatest value is dynamic solvency, i.e. availability during the whole period under investigation.

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