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FINANCIAL DIAGNOSTICS OF ENTERPRISE

In the article the place of financial diagnostics in governing the finances of enterprises is defined. The system of financial ratios that characterize difiierent peculiarities of the activity of enterprises is presented. The detailed analysis of most important financial ratios is provided.

Introduction

As we know from the international experience, the development of a domestic economy demands to apply to business the modem methods of financial management. Effective financial management decisions stimulate the growth of earnings and captal, improve the well-being of its owners and their employees, and that, in its turn, under the conditions of advanced competition, suggests public welfare.

Preparation for making competent management decisions in a very dynamic financial surroundings of Ukraine aggravated by a chronic deficit of financial resources demands from financial analysts, above all, a qualified financial diagnosis of a company. Financial ratios and their relation not just set certain standards, they show the direction to the most advantageous long-term strategies and help to take effective current decisions. They guide the management around crucial problems, which demand immediate consideration. Besides, managers of different levels, knowing main ratios, become able to cooperate efficiently to attain business objectives.

Literature Review

The questions of the control of the enterprises' finances were scrutinized by a great number of scholars, such as, Izmailova K. V., Kovalev V. V., Podderyogin A. M., Tereshchenko 0. 0., Cal-Calko Yu. S. and others. On the other hand, a number of important problems on managing the finances of domestic enterprises in the modern system of management still awaits their solutions. Methodical basis of the applied financial management is mainly grounded on the ideas of foreign scholars, tested in the system of developed market relations of the Western countries. Though they were thoroughly studied, they do not allow to achieve high efficiency in finance management of national enterprises, as they do not reflect the peculiarities of market relations in our country. Hence the necessity in modification of the financial diagnostics of enterprises appears, also in its adaptation to national management conditions.

The system of the financial ratios

The financial diagnostics of an enterprise helps to analyze the criteria of its financial position, reveal disadvantages for its work and devise a plan to achieve its aims. The main task of a financial diagnostics is to promptly give the required information for making a rational economic decision, which will have a beneficial effect on profitability and business solvency of the enterprise.

Most of the recommendations and specifications, which allow to compare the achieved results with set objectives are financial ratios. These ratios show the ratio between the values of the balance sheet and the income statement.

To increase the efficiency of the use of financial ratios they should to be compared with a number of standards [7]. Such standards may be a formulated aim, average branch ratios, and ratios of some competitors or other departments of the enterprise.

The total amount of financial ratios, used to analyze the activity of the enterprise, is quite large. There are more than 200 relative analytic ratios, which can be estimated on basis of financial reports.

Most analysts distinguish a single group of financial ratios on which they concentrate special attention. To make the analysis of the financial ratios more systematic it would be rational to group them. Such classification can be done according to different criteria.

In order to reflect different peculiarities of the activity of an enterprise, the following types of financial ratios should be taken into consideration: asset management ratios; liquidity and solvency ratios; financial independence ratios; financial stability ratios; profitability ratios; market value ratios.

No doubt that the large number of financial ratios and their interpretations often confuses and embarrasses. That is why it's very important for a manager to be able to concentrate his attention on the most considerable ratios and to add all auxiliary ratios and relations quickly.

When analyzing the efficiency of asset management it is hard to determine how efficient a manager is. Pattern of asset use can be judged from the company statement. Large amount of amortization with respect to permanent assets gives reasons to believe that a company has obsolete equipment requiring renovation. If a big sum of money appears in a balance, we can guess a money surplus which can be used more profitable.

In whole, a company is interested in carrying its economical activity having minimum asset reserves. Unjustified surplus and material recession of assets (over 20%) will have a negative effect on economical activity and its financial results [3].

When analyzing current assets it should be taken into consideration, that the main component of current assets are inventories and accounts receivable, which often exceed a 50% of company statement. Specialists believe that the total savings due to the efficient financial management may amount to: 50% - efficient inventory management; 40% - finished goods inventory management and accounts receivable management; other 10% - technological cycle management.

A part of current assets formed from equities and non-current liabilities makes a working capital. It's considered that the working capital value should not exceed 30% of total volume of a company's current assets [2].

To notice trends in the application of assets, a number of turnover ratios are used. These ratios are based on a relation of a company's sales and its assets, necessary to achieve such result.

All turnover ratios of short-term assets and liabilities are within the financial cycle. Thinking of a working capital only as of inventories, accounts receivable and accounts payable, the financial cycle then is a time interval, during which the working capital makes one transaction. In other words, transaction of working capital days corresponds to the duration of a financial cycle. Although the working capital means all assets and current liabilities, this term can be used in such sense for, firstly, the major articles are inventories, accounts receivable and accounts payable; secondly, the behavior of these articles is quite spontaneous, unlike the not-included items - funds and short-time credits - which completely depend on the policy of a company.

Important stage of asset management analysis is a comparison of assets growth rate with a growth rate of financial results (sales and earnings), which shows capital intensity ratio. If an earnings acceleration rate is higher than a sales acceleration rate, while the sales acceleration rate is higher than the assets acceleration rate then in the accounting period the use of assets was more efficient than in a prior period. In an inflation environment it's reasonable to consider a growth rate of a volume. If an earnings acceleration rate is higher than the assets acceleration rate, while the growth rate of a volume is lower, then the efficiency enhancement of assets application was only due to the price increase for products.

Two of the sure signs of a stable financial position of a company are its liquidity and solvency. Liquidity refers to the availability of money in the near future after financial obligations of the present period were discharged. Solvency relates to the availability of money during a longer period so that financial obligations are fulfilled in proper time.

Reading economic literature you can encounter such terms as liquidity, balance sheet liquidity and unity liquidity [4]. While the balance sheet liquidity means the quality of asset management, i.e. earnings for asset sale alone (at the expense of internal facilities), the unity liquidity depends on a company's reputation, its investment attraction, which allows the company to obtain extra funds. A level of liquidity is determined by a period of time necessary for its conversion into money. The shorter the period, the higher the liquidity. An asset can be often sold in no time, but at a considerable discount.

The short-term liquidity of a company is analyzed by making a comparison of a value of its circulating assets with its current liabilities. The three main methods to represent this relation are: current ratio, quick ratio and absolute ratio.

The current ratio defines if current assets are adequate for satisfying current liabilities. The value of this ratio has to be over 100%. In economically developed countries the value of this ratio is within 150%, speaking of Ukrainian enterprises the value of this ratio is 105% on average. In Germany the approximate value of this ratio is 171.2% for the manufacturers, 127.2% for the wholesale companies, and 124.3% for the retail corporations.

The quick ratio shows the possibility of paying off short-term liabilities by current assets less inventories. The average value of this ratio is 80-90% for European companies and 60-70% for Ukrainian. The logic of this ratio is quite simple. Amount of proceeds, gained from the forced sale of inventories is considerably less than their purchase cost. Say, abroad, the assets of closing-down companies are usually sold for less than 40% of their book value. Western analysts recommend an over-than-50%-ratio as optimal. According to German financial analysts, the value of this ratio varies depending on the branch of industry as follows: the average 108.2% for the manufacturers, 78.7% for the wholesale business, and 46.0% for the retail business.

The absolute ratio indicates the share of current liabilities, which can be paid off ad locum, for instance, in case of emergency. Theoretical value should be over 0.2-0.5.

Financial independence of a company is such a state of financial resources, in which it is able to freely maneuver its funds to guarantee a continuous process of economical activity as well as to recreate and widen it. In other words, it meets the demands of a company's development and satisfies the requirements of the external environment. The main ratios for the analysis of company's financial independence are: autonomy ratio, debt ratio, debt-equity ratio, flexibility ratio.

The autonomy ratio characterizes the concentration of an own capital. A number of analysts think that the autonomy rate should not be less than 0.5-0.6 [5]. However, for instance for the Japanese companies it's 0.2-0.3. For the majority of domestic agricultural companies the value of this ratio is within 0.8-0.9, which is not an evidence of their financial stability, but rather the sign that there's no outside financing. So when analyzing the autonomy ratio it's necessary to focus attention on the availability of economically sound external sources of finance in the liabilities of a balance. If a company has a well-defined business-plan, carries out an aggressive policy of market penetration, increases its producing capacities the autonomy ratio of bare 0.2-0.3 is not the evidence of its critical financial condition. At the same time, if a major portion of a debt capital are past-due accounts payable and not-paid-back-in-time credits the autonomy ratio of 0.8-0.9 may prove to be too low.

Difference of the unity and the autonomy ratio gives a debt ratio.

The debt-equity ratio determines the relation of total liabilities to shareholders' equity. The higher its value is, the higher is the risk of investing a capital into a company. A standard relation is 1:2, when one third of a total capital is composed of a debt. On the one hand, a growth dynamics of the ratio leads to increase in dependence of a company on a debt capital, partial loss of its financial independence, and reduction of its financial stability [6]. On the other hand, it stimulates a growth of a return on equity. It comes from the fact, that the company is interested in the use of a debt capital, for percents on capital servicing are introduced as expenses, thus reducing a profit before tax; also, the interest costs are less than a profit realized from the use of a debt capital, which in whole encourages the growth of a return on equity. A relation of total liabilities with shareholders' equity varies for different sectors. It depends on a country's culture as well as on a current capital. The faster the current capital, the higher this ratio can be.

The flexibility ratio points to a part of an own capital invested in current assets and characterizes the increase of an equity mobility ratio, namely, the current capital, which ensures the necessary flexibility in the use of money, i.e. used for current activity. To provide sufficient flexibility and mobility of an own capital, the ratio should be rather high [1].

The financial stability of a company is based on efficient financial management and is distinguished for its optimal structure of assets, and optimum relationship between own and debt capital. The latter is characterized by relative ratios of financial independence, where one of the main is a financial risk ratio. The main absolute ratio is a working capital value. Relation between separate constituents of capital formation sources gives an opportunity to describe the type of a financial stability. The structure of assets and funding sources affects the amount of profit, characterizes a risk of insolvency, and is determined by leverage. Margin of financial stability is found considering the break-even sales and is calculated as a current and forecast value.

In market relations environment the efficiency ratios of a company, which show its level of profitability are of great importance. Profitability ratios determine a relative profitability, which is in percentage ratio to the use of resources or capital from different attitudes. The growth of all profitability ratios is a positive moment, while a payback peri od is a negative one. Financial diagnostics usually require a total profitability analysis, a capital profitability analysis, and a capital transformation analysis.

A company's position on a stock market is determined by market value ratios: dividend yield, earnings per share, price-earnings ratio etc.

Conclusions

Managers that work in modem dynamic economical environment should constantly absorb more and more information. Financial ratios serve as guiding lines for managers, they point out important ties and interdependence between different aspects of business. Each financial ratio does not require any complicated calculations; the understanding of a subject is not in the way in which these calculations are done, but in realizing how to evaluate the results accurately, and how to combine different ratios to get a clear image of a financial state of a company. Financial diagnosis allows to understand a state of affairs in one or another company's business field, helps to correctly estimate a state of a company and work out recommendations for making optimal management decisions.

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ФІНАНСОВА ДІАГНОСТИКА ПІДПРИЄМСТВА

У статті визначається місце фінансової діагностики в управлінні фінансами підприємств. Наводиться система фінансових коефіцієнтів, що характеризує різні особливості діяльності підприємства. Докладно розглядаються найважливіші фінансові коефіцієнти.