DIAGNOSIS OF FINANCIAL LIQUIDITY AND SOLVENCY -TOOL OF THE APPRECIATION OF THE ENTITY PAYING CAPACITY

HADA IZABELA DIANA,
PH.D STUDENT, „1 DECEMBRIE 1918" UNIVERSITY OF ALBA IULIA
e-mail:izabela_hada@yahoo.com

MIHALCEA MIHAELA MARIA,
PH.D STUDENT, „1 DECEMBRIE 1918" UNIVERSITY OF ALBA IULIA
e-mail:miha.ela_89@yahoo.com

DOHAN (LITAN) CRISTINA SUSANA,
PH.D STUDENT, „1 DECEMBRIE 1918" UNIVERSITY OF ALBA IULIA
e-mail:d_litan@hotmail.com

Abstract: *In the economic area that enables entities is often assailed by numerous changes: economically, socially, and financially. In a competitive environment entities must know resources to assess risks that may affect the activity, to fix the vulnerability in the face of the economic environment, to measure weaknesses, opportunities for development, thus leading to the smooth implementation of the objectives and the development of the enterprise. The main purpose of this article is to those out to the importance of diagnosis of the liquidity and financial solvency, as a means of appreciation the payment capacity of the entity, both short-term and long-term. Research shows us that the diagnosis gives us a realistic view of the entity paying capacity by identifying strengths and weaknesses in terms of liquidity and solvency of the entity. The diagnosis of the two components constitutes a preventive measure against the risk of insolvency, to be used by policymakers for substantiation.*

Keywords: *solvency, liquidity, insolvency, the role of the diagnosis, strengths and weaknesses of paying capacity*

Classification JEL: M40, M41

1. Introduction

Any entity must adapt to the conditions of a competitive environment increasingly more complex, difficult, and channeled on results without putting the value factors that lead to the achievement of strategic objectives. The need for risk assessment brings with it the necessity of carrying out certain calculations, based on certain factors taken as a basis for calculation, interpretation of results and the proposed measures to tackle the economic, financial, accounting obstacles. We believe that one of the main obstacles is the inability of financial payment, has withdrawn the obligations arising from the financial and economic activity. Starting from the need for knowledge of the availability of financial resources, the main purpose of this article is to those out to the importance of diagnosis of liquidity and financial solvency, as well as the appreciation of the capacity to pay of the entity, both short-term and long-term. Research shows us that the diagnosis gives us a realistic view of the entity paying capacity by identifying strengths and weaknesses in terms of liquidity and solvency, constituting a preventive measure against the risk of insolvency.

2. Methodology of research

In this article, the literature review aims at presenting the current state of knowledge, through recourse to citations, highlighting current concepts regarding diagnosis liquidity and solvency. At the same time, theoretical documentation of allowed presentation of concepts considered significant in relation to the topic studied as well as the importance of diagnosis of liquidity and solvency in prevention of the risk of insolvency.

The case study used aimed at illustrating how the diagnosis of liquidity and solvency shall mean the instrument of determining the strengths and weaknesses with regard to the capacity to pay of the entity. Participatory observation was used for the analysis and interpretation of the results of the study case, and last but not least, grounding some opinions in the light of the results obtained and the achievement of the objectives proposed.

3. Literature review

In the literature a number of views regarding the importance of diagnosis, some more synthetic, others more comprehensive. In agreement with the opinion presented in a study (Șușu Ș. & Bîrsan M., 2009), diagnosis ensures decision-makers a realistic harmful process; assess the financial situation with regard to the undertaking. Moreover, the same source cited considers that diagnosis is aimed at identifying weaknesses, in order to correct them and strengths in order to exploit them in achieving better results, the latter must be capitalized, thus representing the future opportunities of the undertaking's activity. From this vision, we consider that, diagnosis treats various problems related to liquidity, solvency, performance, risk, financial balance and lead to the identification of ways to improve profitability entity, reduction of costs and to achieve desired monetary surplus. The main issue in this case is identification of strengths or weaknesses. In this sense, some authors (Deac V & Dună V.A., 2012) support this issue by detailing strengths (key success factors that enable the company's improving aspects that could compromise the future development) and weaknesses of a company considered to be its features which places the company in a position lower than that of companies that compete with it. Diagnosing offers the opportunity of proper planning to mitigate the risks (Andekina R.& Rakhmetova R., 2013).

The diagnosis of an organization activity formulate recommendations for the reduction of the negative aspects and/or to exploit strengths (Achim M.V., 2015). Diagnosis involves sightings of symptoms, disruption, establishing economic and financial status of the entity, prescribing "therapy" to redress a situation existing at a given time (Achim M.V., Borlea S.N, 2017). Some authors (Gâdoiu M., 2007) believes that the company is studying the ability of diagnosis to ensure immediate solvency and in a timely manner, avoiding the risk of bankruptcy; the ability of the company to be effective enough, considering the resources involved in the activity; and last but not least, the ability of the company to provide sufficient resources to deal with financial risk. Support the idea presented by some authors (Suciu G., Bîrsan N., 2013), diagnoses detects potential situations of financial imbalance. The diagnosis is a financial management tool that can be used successfully (Pop I.L., 2017).

The importance of diagnosis is confirmed by some authors (Balteș N., 2010), who believes the role of the financial diagnosis is a "System Center" for guiding management decisions, making the act of management should not be carried out on the principle of spontaneity and the intuition. The same approach, which we support, we can find at the authors (Spătaru L, Stancovici A., 2014) who states that the diagnosis provides useful information on the chances of the company, as well as the direction and trend of modern business. Note to this bibliographic source the idea that diagnosis involves a difficult endeavor, sprinkled with various obstacles and traps, and his importance derives from the fact that a wrong diagnosis leads to further evaluation.

A concept frequently encountered in literature is the liquidity. Both in theory and in practice carrying it speaks more and more about liquidity. Users follow the entity's ability to be liquid, to be able to convert their assets into cash to meet obligations arising from the activity of the entity's annual accounts. If the company which is not able to honour its short-term financial obligations, it moves a step ahead towards its bankruptcy (Panigrahi A.K,2014). The same source cited the role of liquidity, witch has been taken as an important tool to analyze the sustainability and liquidity position of any enterprise that may also help to derive maximum profits at minimum cost; and a company must maintain its ability to pay off its current obligations and have a sound base of working capital to stay for a long period in the competitive market. Liquidity is considered a good indicator of the ability of the firm to pay the bills and to repay loans, as a necessary condition for the survival of the company (Căruntu G.A., 2016). Liquidity is an investment in short term assets alternative to other forms of resource allocation with important implications for corporate proftability, risk and fnancial soundness, and, more generally, for economic growth (Dottori D, Mucucci G.,2018). Other authors referring to the relationship between performance and liquidity. So, Alipoor M., Shoorvarzy M. (2017) mentioned that financial performance evaluation is determined by two power indicator liquidity and profitability.

Just like the liquidity, solvency represents an important component of the activity. Numerous studies refer to the concept of solvency. Many of these focus on the company's ability to pay off debts to the time limits. Solvency refers to the willingness to use the cash on a longer time period, when society is to honor outstanding financial commitments (Căruntu, 2016). The same source cited the importance of attitudes and information related to the financial structure, which is useful for anticipating the future lending and how future profits and cash flows will be divided between those who have an interest in the company, as a possible insufficiency of resources influences the long-term solvency and profitability.

4. Results and discussions

To diagnose the financial solvency and liquidity we have conducted a case study at a metallurgical company in the field of using several indicators, such as: the rate of current liquidity, the rate of immediate liquidity, of effective liquidity, working capital and the rate of working capital, the rate of general solvency, the rate of long-term solvency, debt repayment capacity, the rate of coverage of debt interest from result, the coverage rate of debt interest from cash. Research results are presented in table no.1.

Table no.1. Financial liquidity and solvency to the analyzed company

INDICATORS	2015	2016	2017
Financial liquidity			
1. The rate of current liquidity (Rlc)	353,18%	491,22%	466,48%
2. The rate of immediate liquidity (Rli)	208,20%	318,06%	310,16%
3. The rate of effective liquidity (Rle)	21,92%	88,05%	69,19%
4. Working capital (CL)	26.998.190	27.102.371	31.679.000
5. The rate of working capital (Rcl)	47,81%	51,35%	54,42%
Financial solvency			
6. The rate of general solvency (Rsg)	425,56%	604,89%	580,27%
7. The rate of long-term solvency (Rsgl)	2.549,73%	2.552,14%	3.575,07%
8. Debit repayment capacity (Crd)	0,47	0,20	0,41
9. The rate of coverage of debt interest from result (TIE)	59,58	8,27	61,77
10. The rate of coverage of debt interest from cash (CCR)	55,70	14,64	54,53

Source: Indicators were calculated using data from the financial statements of the company

It finds a value well above the safety threshold of all liquidity indicators, which show us that society has a high enough level of assets compared to current debts and short-term, society will cope successfully with the obligations that it has. This gradual increase, from year to year, we confer and guarantee a certain entity capacity of honor the future obligations outstanding. The rate of effective liquidity demonstrates that treasury can cover in full the debts. Analyzing working capital note that entity is in short-term financial balance throughout the period under review. With regard to solvency, the company is in a favorable situation, and carrying out certain measures will lead to even more good coverage of the long-term debt at the expense of assets. The company enjoys in this case of a solvency surplus to exceed the safety threshold value. With regard to debt repayment capacity, due to the decrease in the net result in the year 2016, we're talking about a value less than the limit allowed, but an average status is generated by the maintenance of values in the year 2017. This can be seen from the chart no. 1. about the evolution of the current liquidity and solvency of the entity analised.

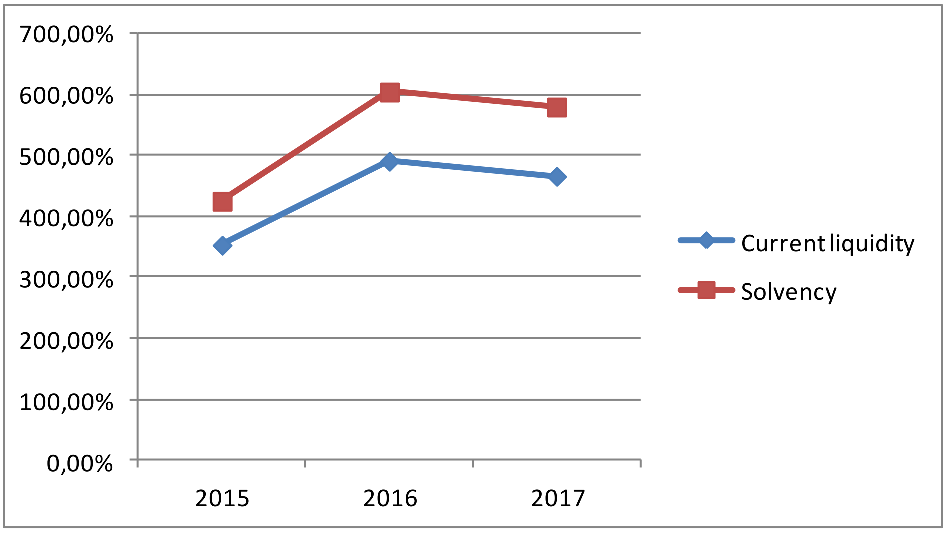

Diagram no. 1. *The evolution of the current liquidity and solvency*
Sours: own screening

Calculated on the basis of indicators, we have achieved the synthesis diagnosis of financial liquidity and solvency, according to table no. 2.

Table no.2. Synthesis of diagnosis of the financial liquidity and solvency

IND.	OBSERVATIONS	SWOT Diagnosis	Pct	Imp.	Agreg	Necessary measures
1. Rlc	Values very consolidated, far above the upper limit (150-250%) of the range safety	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level
2. Rli	Values very consolidated, far above the upper limit (50-100%) of the range safety	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level
3. Rle	Although values highly consolidated over the upper limit (20-60%) of the time, we are witnessing a substantial increase in 2016, followed by a deterioration in 2017	Forte status/slow improvement and deterioration	4	20 %	0,8	Increasing the Bank availability of asset plus short-term
4. CL	The company is in financial balance in short term, reinforcing balance from year to year	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level
5. RCL	Working capital rate values highly consolidated, with values which lies far above the average of countries (5%), with higher values from year to year	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level
Diagnosis of liquidity	**Liquidity ratios analysis noted that the society presents a good level of financial liquidity status, thus reflecting a good capacity to pay debts immediately due**	**STRONG POINT**		**100 %**	**4,4**	**Maintain this level and Increasing the Bank availability of asset on short-term**
6. Rsg	Values very consolidated, far above the upper limit (150-300%) of the range safety	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level

7.Rsgl	Values very consolidated, far above the upper limit (80-180%) of the range safety	Forte status/slow improvement	4,5	20 %	0,9	Maintain this level
8. Crd	Values above the limit of 0.25 in the first year following a fall below the threshold, and a return to the value in the first year	Average status/ Maintenance	3	20 %	0,6	Increase in capacity of self-financing, the increase of net result
9. TIE	Although recorded a significant drop in the second year, the tendency is to maintain	Average status/ Maintenance	3	20 %	0,6	Increase of cash, reducing debt interest
10. CCR	Although recorded a significant drop in the second year, the tendency is to maintain	Average status/ Maintenance	3	20 %	0,6	Increase of result, reducing debt interest
Diagnosis of solvency	**Solvency rates noted that the entity shall submit a satisfactory level of solvency, representing a hard point for managing entity, satisfactorily to fulfill obligations**	**STRONG POINT**		**100 %**	**3,6**	Maintain this level and increase of cash, result, reducing debt interest

Source: own screening

Liquidity ratios analysis noted that the society presents a good level of financial liquidity status, thus reflecting a good capacity to pay debts immediately due. Solvency rates noted that the entity shall submit a satisfactory level of solvency, representing a hard point for managing entity, satisfactorily to fulfill obligations.

5. Conclusions

In the work to achieve the objectives an entity must take account of all the factors which compete in the smooth operation of the business, to always identify anomalies, to propose measures of decentralization and factors of production, and, most important, to establish his own economic balance. With the aim of highlighting the importance of diagnosis of the financial solvency and liquidity as an instrument of appreciation the payment capacity of the entity, both short-term and long-term results of this Research shows us that the diagnosis gives us a realistic view of the entity paying capacity by identifying strengths and weaknesses in terms of liquidity and solvency of the establishment, by means of indicators such as: the rate of current liquidity, immediate liquidity, effective liquidity, working capital and the rate of working capital, the rate of general solvency, a long-term solvency, debt repayment capacity, the rate of coverage of debt interest from result, the coverage rate of debt interest from cash.

Diagnosis of the liquidity and solvency helps entities to assess the risks that may affect the ability to pay to fix the vulnerability in the face of the economic environment, to measure weaknesses, opportunities for development, a preventive measure against the risk of insolvency, to be used by policymakers for substantiation.

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