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# ISSUES IN THE ANALYSIS OF FINANCIAL STABILITY OF AN ENTITY

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***Abstract:*** *Ensuring a company's financial stability is a key factor for its future success. Therefore, analyzing financial stability serves as the foundation for decision-making by potential investors, buyers, and suppliers. This article discusses the necessity and methodology of analyzing a company's financial stability. It examines solvency analysis for the near future and financial stability analysis for the long-term perspective.*

***Keywords:*** *sustainable activities, income, expenses, assets, liabilities, balance, solvency, long-term assets, current assets, equity, borrowed capital, long-term loans, long-term credits, short-term loans, short-term credits, own working capital, attracted funds, coverage ratio.*

One of the most significant indicators of a company's stability is its financial stability. Achieving financial stability is possible if the company's revenues exceed its expenses. A company can be considered financially stable if it can freely manage its funds, use them effectively, and maintain a continuous production and sales cycle.

Financial stability is an integral part of a company's overall stability, characterized by balanced financial flows and sufficient resources to support the company's operations over a certain period, including servicing loans and producing goods.

The financial condition of a company can be evaluated both in the short-term and long-term. In the short term, the focus is mainly on the company's solvency, while in the long term, financial stability becomes the priority.

Companies that do not develop financial stability are at high risk of bankruptcy. Therefore, analyzing financial stability at both macro and micro levels has always been a critical area of focus for economists.

Financial analysis places significant emphasis on assessing the financial stability of individual enterprises, firms, and companies, distinguishing between short-term, medium-term, and long-term evaluation practices, and determining specific measures to enhance financial stability.

Various systems of indicators are used to assess financial stability, including:

- Company solvency
- Dependency ratio on own funds
- Asset dependency ratio
- Interest coverage ratio

Proper formation, allocation, and efficient use of financial resources are essential factors in ensuring financial stability. In essence, financial stability reflects how skillfully a company manages its financial resources.

To ensure financial stability, companies should focus on forming initial capital, organizing production, achieving positive results between income and expenses, ensuring sufficient working capital, maintaining financial independence, and protecting business and market activities.

Financial stability is assessed through absolute and relative indicators. Absolute indicators reflect the state of assets, production reserves, and funding sources over a specific period. Funding sources include own funds (such as charter capital, reserve

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capital, additional capital, retained earnings, and targeted income), long-term and short-term loans, and liabilities.

If long-term loans and liabilities dominate asset financing, then short-term loans and liabilities are commonly used for funding production reserves.

The following indicators are used to determine financial stability:

- Long-term assets
- Production reserves
- Source of funds
- Long-term liabilities (loans and debts)
- Short-term liabilities (loans and debts)

Diagnosing a company's financial condition and implementing specific measures for improvement are essential factors in ensuring macroeconomic stability. Therefore, financial well-being must be prioritized to ensure the company's stable growth in the future.

A company's financial condition is characterized by the availability of financial resources, their effective allocation and utilization, financial relationships with other legal and physical entities, and indicators of solvency and financial stability.

Relative indicators of financial stability describe the maintenance of active (long-term) and reserve financing, financial stability and dependence, and positive outcomes from the involvement of own and borrowed funds.

One of the most critical factors in ensuring financial stability is maintaining order based on the golden rule of economic science, which emphasizes achieving positive outcomes from activities.

The general formula for this procedure is:

$$NP_1/NP_0 > SR_1/SR_0 > OE_1/OE_0 > A_1/A_0 > 1$$

or

$$NP_1/NP_0 * 100 > SR_1/SR_0 * 100 > OE_1/OE_0 * 100 > A_1/A_0 * 100$$

Where: $NP_1/NP_0$ – Growth in net profit; $SR_1/SR_0$ – Increase in sales revenue; $OE_1/OE_0$ – Growth of Owner’s Equity; $A_1/A_0$ – Growth of assets.

Asset allocation depends not only on the company's performance but also on its financial condition.

The primary requirements for liability allocation include maintaining a high share of private capital in overall financing and ensuring that private capital is not dependent on borrowed capital. In other words, companies must strive for financial independence and maintain an appropriate ratio of equity.

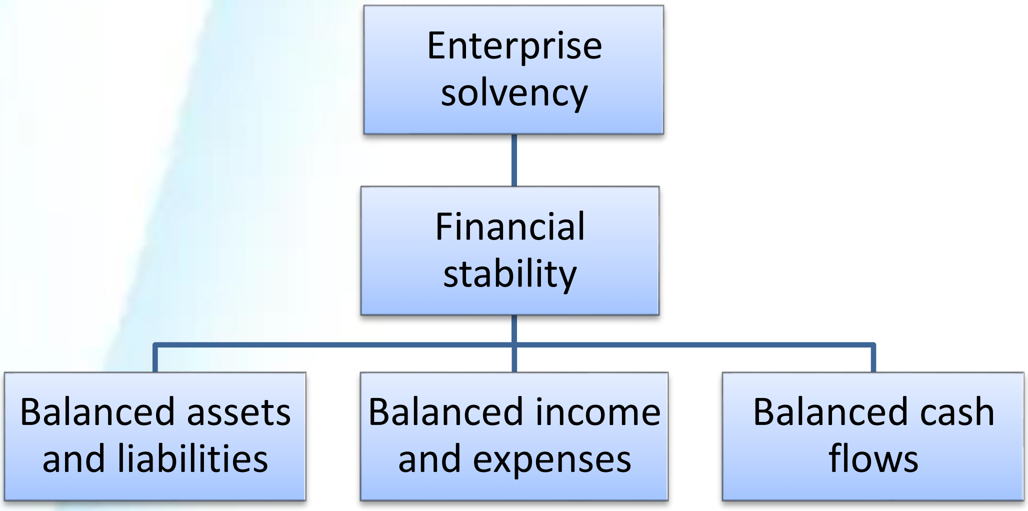
The dependency can also be observed in the calculation of indicators determining the adequacy or inadequacy of own and borrowed funds for financing reserves and expenses. When own investments are insufficient, attracting long-term and short-term liabilities becomes a constant requirement for business operations. Therefore, when using liabilities to finance assets, it is necessary to focus on profitability ratios and ensuring their continuity.

Financial stability ratios include the equity ratio, debt-to-equity ratio, financial dependency ratio, mobility ratio of equity, concentration ratio of borrowed financing, and debt-to-equity ratios. The objective of determining financial stability is to evaluate the company's ability to cover its liabilities and maintain them over a long period.

The financial condition of a company can be categorized as stable, unstable (pre-crisis), or crisis. The ability to make timely payments, finance operations on an extended basis, withstand unexpected shocks, and maintain solvency under adverse conditions indicates a company's stable financial condition. Conversely, failure to meet these criteria suggests financial instability.

If current solvency reflects the external aspect of a company's financial condition, then financial stability represents the internal aspect that ensures long-term solvency through balanced:

- Assets and liabilities,
- Income and expenses,
- Positive and negative cash flows.




Further analysis of financial stability indicators in Uzbekistan indicates varying practices in defining financial stability indicators. The system of indicators can be grouped into two main components:

1. Indicators related to the structure of assets, capital, and liabilities, such as financial independence, financial dependence, solvency, and coverage ratios.
2. Indicators related to asset financing, such as the availability of own working capital, debt ratios, financing of inventories with own funds, and net working capital.

In Uzbekistan and CIS countries, regulatory standards are applied to financial stability indicators, which differ from international practices. Financial stability is commonly assessed in absolute terms, focusing on three key indicators:

- Availability of own working capital (AOWC),

AOWC = SC - FA

where: SC– sources of own funds; FA – fixed assets (long-term assets).

- Funding of reserves through own and borrowed funds (SFI),

SFI = AOWC + LTL

where: LTL – long-term loans and debts.

- Funding of reserves through all resources (SFIR),

SFIR = SFI + STL

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where: STL – short-term loans and debts (including settlements with suppliers and contractors).

Finally, it is essential to regularly monitor turnover of working capital, improve asset structure, optimize the credit portfolio, and prepare internal documents that accurately reflect financial conditions, including solvency, receivables and payables, and planned expenditures and income. To perform monitoring activities, following calculations should be done:

| **Calculation of the availability of funds and the level of inventory financing:** | | |
|---|---|---|
| **Indicator** | **Function** | **State of Inventory Financing (+, -)** |
| Availability of Own Working Capital (AOWC) | AOWC = SC - FA | AOWC - IC |
| Availability of Own Working Capital and Long-Term Loans and Debts (AOWCLD) | AOWCLD = SFI - FA | AOWCLD - IC |
| Availability of Total Working Capital (ATWC) | ATWC = SFIR - FA | ATWC - IC |

Table 1: Self-made by authors, IC - Inventory and Costs

Additionally, the sufficiency of funds for financing inventories can also be calculated using the ratio method. Below in the table are the key ratios depicted for this purpose:

| **Ratios of Working Capital Provision** | | |
|---|---|---|
| **Ratio** | **Formula** | **Normative Level** |
| Own Working Capital Provision Ratio | OWC / IC | 0.6–0.8 |
| Own Working Capital and Long-Term | OWCLD / IC | Minimum 1.0 |

| | | |
|---|---|---|
| Borrowed Funds Provision Ratio | | |
| Total Working Capital Provision Ratio | TWC / IC | Above 1.0 |

Table 2: Self-made by authors

The ratio method plays important in a comparative analysis of the state of inventory financing and its positive changes. The level of a company's financial stability can be evaluated based on the current state of inventory financing from relevant sources. The classification of norms can be summarized as follows:

| **Classification of Financial Stability** | | | | |
|---|---|---|---|---|
| **Type of Financial Stability** | **OWC vs IC** | **OWCLD vs IC** | **TWC vs IC** | **Financial Condition** |
| 1. Absolute Financial Stability | OWC > IC | OWCLD > IC | TWC > IC | Fully financed by own funds; no reliance on external borrowing. |
| 2. Normal Financial Stability | OWC < IC | OWCLD > IC | TWC > IC | Financed by own funds and long-term loans; minimal short-term borrowing. |
| 3. Unstable Financial Condition | OWC < IC | OWCLD < IC | TWC > IC | Reliance on short-term borrowing; potential liquidity risks. |
| 4. Critical Financial Condition | OWC < IC | OWCLD < IC | TWC < IC | Insufficient funds to cover inventories; high risk of insolvency. |

Table 3: Self-made by authors

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Based on the research done, the following conclusions can be made:

- ✓ Increase Equity Capital. This can be achieved by increasing revenue and profitability. Another way to boost equity is to revise the dividend policy of entity.
- ✓ Optimize accounts receivable and payable by improving the management of debtors (receivables) and creditors (payables) to ensure timely collections and payments.
- ✓ Reassess the company's cash flow management practices.
- ✓ Improve the company’s asset structure by changing the proportions of long-term and current assets.
- ✓ Increase the share of long-term loans meanwhile reducing reliance on short-term loans as its proportion reduces.
- ✓ Regular calculations of absolute and relative indicators are needed that reflect the company's dependence on borrowed funds and its overall solvency.
- ✓ Monitor the turnover of working capital continuously and pay special attention to its standardization.
- ✓ Develop internal documents tailored to the company's needs and provide a comprehensive picture of issues related to solvency, accounts receivable and payable, planned expenses, and cash inflows.

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