# ANALYSIS OF THE FINANCIAL BALANCE FOR A COMPANY AND ITS IMPORTANCE

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***ABSTRACT***
*The analysis of the financial balance of an entity's assets aims to reflect the equality of the sources of funding and the uses of financial resources, between the revenues and expenses associated with the performance of the entity's business in the long, medium, and short term.*
*The analysis of the financial balance requires static analysis, as well as dynamic analysis using balance indicators, and is based on balance sheet.*

***Key words:*** *Financial balance, working capital, required working capital, treasury, financing rates, liquidity rates.*

***JEL classification: M41, K22***

## INTRODUCTION

The concern for ensuring general economic balance, and financial in particular, has been the focus of the most important economic schools, with an emphasis on short-term balance and then looking for solutions to ensure the long-term one.

In a simplified form, financial balance is defined by the equality between revenue and expenditure. However, in a financial determination, the financial balance expresses the equality between the financial sources and the economic means necessary to conduct the exploitation activity and commercialization in the long and short term.

An analysis of the structure of the financial balance is necessary in view of its power to reveal the quality of the financial balance at a given time or in the process. A distinction must be made between static balance at a given time and dynamic, continuous balance.

The analysis of financial balance involves comparing certain categories of assets, capital and liabilities through specific indicators applied to the financial balance sheet. To obtain the financial statement, a prior treatment of balance sheet data is necessary in order to adapt them to the criteria that allow a meaningful financial analysis. The financial statement leads to the determination of real and comparable indicators of the financial balance in the long and short term. The financial analysis thus becomes much more relevant and makes it possible to obtain more reliable informative references.

## 1. GENERAL CONSIDERATIONS REGARDING FINANCIAL BALANCE

"Financial balance is a basic condition for carrying out profitable activities and a financial balance is achieved by adjusting a long range of imbalances that manifest themselves in the current activity of the company."[1].

According to some authors, "the financial balance can be defined by the company's ability to ensure from its receipts the uninterrupted payment of current debts arising from the realization of its business, so that it can avoid the risk of bankruptcy. Maintaining financial balance is an essential condition for the survival of the company, and the assessment of the financial balance must consider the specific circumstances of the occurrence of insolvency."[2]

Another approach states that "the financial balance expresses the equality between the financial resources and the economic means required to carry out the activity of exploitation, investment and financing in the long, medium and short term".[3]

## 2. SPECIFIC INDICATORS ASSESSMENT OF THE FINANCIAL BALANCE

According to some authors[4] **the assessment of the financial balance** is carried out through balance indicators, respectively net position, working capital, the required working capital and net treasury.

***Financial balance rates***[5] "are an expression of the achievement of the company's long-term and short-term financial equilibrium, showing the existence or insufficiency of working capital, working capital requirements and net treasury".

The analysis of financial balance can have two approaches, namely:

- *a static approach*: financial balance indicators are calculated on the basis of the financial statement and reflect a static image (at some point in time) of how to achieve financial balance,
- *a dynamic approach*: financial balance indicators are calculated on the basis of the functional balance sheet and the financial balance considered from the perspective of continuing the activity.

The analysis of the financial balance has the following objectives:

- „*short-term balance*: when comparing working capital with the need for working capital (treasury),
- *current balance*: when comparing capital current assets with short-term liabilities (WCR),
- *long-term balance*: when comparing permanent capital with fixed assets (Working capital)" [6].

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[1] Mihai, I. Cazan, E. Buglea, A. Lala, Popa Ion. Ștefea, P. Broşteanu, Georgeta. Ivoniciu, P. Pantea, M. (2009). „Analiza situației financiare a agenților economici". Editura Mirton, Timișoara. p. 89

[2] Sabău.Crăciun, Nagy.Cristina Mihaela. Uher, Marina. (2015). „Contabilitatea reorganizării şi lichidării întreprinderii, Ediția a II-a". Editura Eurostampa, Timişoara. p. 130

[3] Rotărescu, Vasile. (2007). „Analiza echilibrului financiar: metode clasice și moderne". Editura Orizonturi Universitare, Timișoara, p. 9

[4] Iosif, Gh. N. (2014). „Analiza echilibrului financiar pe baza bilanțului contabil". Revista Tribuna Economică, nr. 39. Editura Tribuna Economică. București. p. 62

[5] Balteş, Nicolae. (2007). Analiză și diagnostic financiar – suport de curs, Sibiu,

[6] Sabău, Crăciun, Medinschi, Silvia, Buzilă Nicoleta (coordonatori). (2011). „Ghidul antreprenorului privat". Editura Mirton, Timișoara, p. 162

***Working capital*** is the company's safety margin, determined by the differences between the amounts to be collected and the amounts to be paid, as well as by the gap between the average time taken to convert current assets into liquidity and the average duration in which short-term liabilities become due.[7]

The working capital can be determined in two ways, namely:[8]

a) as a difference between permanent capital and net fixed assets:

Working capital = Permanent capital - Fixed assets

In this case, the working capital marks the surplus or availability of permanent capital above the net value of the fixed assets, which can be allocated to the financing of current assets.

b) as the difference between current assets and short-term liabilities[9]:

Working capital = Current assets - Short-term liabilities

In this case, the working capital marks the current assets financed from stable sources or the surplus of current assets over short-term liabilities.

For a company with a long manufacturing cycle to operate normally, the working capital must finance 40 % of current assets.

For the normal operation of a company with no specific stock problems, which falls within normal production terms, the working capital represents 10 % of turnover or 20 % of working assets.

In the services sector, working capital is required, even if the companies concerned do not have stocks, the role of working capital is to adjust the gap between the duration of receivables and liabilities.

"**Working capital requirement (WCR)** is the part of cyclical assets to be financed from stable sources, respectively current assets (with a liquidity term of less than one year) to be financed from stable sources (with an expected maturity of more than one year)."[10]

An entity's *WCR* must cover the existing gap between cyclical needs (stocks and receivables) and cyclical resources (suppliers and other short-term debt (StD), excluding short-term loans). It can be determined using the following relation:[11]

$$\mathbf{WCR = (Ca - Lqa) - (StD - Cbl)}$$

Where:

Ca – current assets

Lqa – liquid assets

Cbl – current bank loans (short term).

WCR's analysis "highlights several situations, the most conclusive of which are:

***a) WCR > 0, A** $_{cyclical}$ **> L** $_{cyclical}$ signifies the existence of a surplus of cyclical needs in relation to the possible cyclical sources to be immobilized. A positive WCR*

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[7] Costea, Simona Cristina. (2009). „Analiză economico- financiară", Editura Eurostampa, Timișoara, p. 45

[8] Sabău, Crăciun Nagy, Cristina Mihaela. Uher, Marina. (2015) „Contabilitatea reorganizării și lichidării întreprinderii,", Editura Eurostampa, Timișoara, p. 144

[9] Costea, Simona Cristina, (2009). „Analiză economică financiară". Editura Eurostampa, Timișoara. p. 44

[10] Sabău, Crăciun Nagy, Cristina Mihaela. Uher, Marina.(2014) „Contabilitatea reorganizării și lichidării întreprinderii,", Editura Eurostampa, Timișoara, p. 144

[11] Costea, Simona Cristina, (2009). „Analiză economică financiară". Editura Eurostampa, Timișoara. p. 44

*highlights an unfavorable gap between the liquidity of cyclical assets and the maturity of exploitation liabilities.*

***b)** $WCR < 0$, $A_{cyclical} < P_{cyclical}$ reflects a surplus of cyclical needs in relation to cyclical assets. The situation is favorable due to the acceleration of the rotational speed of cyclical assets and the engagement of some exploitation liabilities with more relaxed maturities."*[12]

If the size of the Working capital depends on long-term decisions on the investment policy and the financing policy of the enterprise, the WCR results from the short-term gaps between expenditures, revenues, and settlements that it generates. Working capital and working capital requirements are therefore based on different causes, and the difference between the two indicators is the treasury.

At the level of an enterprise, "the treasury is represented in the form of a table of monetary availability and short-term payments, derived from current receipts and payments."[13]

"Net treasury (NT) is the general balance indicator. It analyzes both long-term and short-term balance, the calculation formula being as follows:

**NT = Working capital – Working capital requirement**"[14]

Represents the excess liquidity remaining after the surplus of cyclical needs (remaining uncovered) by the surplus of permanent resources.[15]

"**Treasury,** in the dynamic version, is defined as the difference between the asset treasury and the liability treasury. Thus, the treasury is calculated according to the following formula:

**Treasury = Active treasury – Liability treasury**" [16]

## 3. FINANCIAL BALANCE ANALYSIS BASED ON FINANCING RATES

Financing rates highlight the ways in which the company's investments can be funded, which can be strategic, operational, and balanced.

For the analysis of financial balance through financing rates, we will use the following rates: [17]

- the financing rate of fixed assets from permanent capital (stable financing rate),
- the financing rate of fixed assets from equity,
- working capital funding rate (overall financing rate),
- the funding rate of the capital invested.

[12] Baiu, Cosmin. (2019). Analiză financiară pe înțelesul tuturor, Editura Evrika Publishing, p. 92.
[13] Horhotă, Luminița. (2020). Analiză economico-financiară, Editura ProUniversitara, p. 194.
[14] ***, CECCAR. (2019). „Analiza poziției financiare a întreprinderii" Revista CECCAR Business Magazine, Nr. 23, 25 iunie - 1 iulie 2019, p. 3
[15] Untaru, Mircea. (2013). Analiză Economico-financiară. Editura fundației pentru cultură și învățământ „Ioan Slavici". Timișoara, p. 82
[16] Costea, Simona Cristina, (2009). „Analiză economică financiară". Editura Eurostampa, Timișoara. p. 69
[17] Untaru, Mircea. (2013). Analiză Economico-financiară. Editura fundației pentru cultură și învățământ „Ioan Slavici". Timișoara. p. 33

**a) The financing rate of fixed assets from permanent capital (Rfa)** reflects the extent to which fixed assets are financed from permanent capital.

This rate reflects the long-term financial balance and shows the extent to which stable assets are financed from stable liabilities. The calculation ratio of the rate of financing of fixed assets (Fa) from permanent capital (Pc) is as follows: $\boldsymbol{Rfa = \frac{Fa}{Pc}}$

**b) The financing rate of fixed assets from equity (Rfe)** expresses the degree to which equity (Eq) participates in the financing of fixed assets (Fa). The calculation ratio for this indicator is as follows: $\boldsymbol{Rfe = \frac{Eq}{Fa}}$

**c) The working capital funding rate ($Rf_{WC}$),** also called the global financing rate, it measures the proportion in which the working capital requirement is covered at the expense of permanent resources (working capital).

The calculation ratio for this indicator is the following: $\boldsymbol{RfWC = \frac{WC}{WCR}}$

**d) The funding rate of the capital invested (RfK)** shows to what extent stable resources (Rs) can cover the capital invested by the enterprise (Cinv).

This indicator can be determined using the following ratio: $\boldsymbol{RfK = \frac{Rs}{Cinv}}$

## 4. ANALYSIS OF THE FINANCIAL BALANCE BASED ON LIQUIDITY RATES

**Liquidity** is the property that the assets (the material part of the capital) have to be transformed into cash.

According to other authors[18] ***the liquidity ratios*** that can be determined are general liquidity, reduced liquidity, and immediate liquidity.

The entity's liquidity analysis tracks its ability its ability to discharge its current liabilities from current resources. This indicator is used to assess the risk of short-term default.

Liquidity is defined by two main characteristics:

- the specific nature of the assets, which have a greater or lesser capacity to be transformed into cash,
- the destination of the liquidity, the liquidity being defined as the entity's capacity to cover from its assets the most liquid liabilities in the short term.

Most often, in the literature, the assessment of the level of liquidity is made by using four indicators, namely, the general liquidity ratio, the reduced liquidity ratio, the current liquidity ratio and the immediate liquidity ratio.

**1. The general liquidity ratio** expresses the company's ability to meet its short-term (exploitation) obligations from operating assets. It is calculated as a ratio between average current assets and average current liabilities: $\mathrm{gl} = \frac{\overline{\mathrm{Ca}}}{\overline{\mathrm{Cl}}}$

[18] Buglea, Alexandru. (2010). „Diagnosticul și evaluarea întreprinderii". Editura Mirton, Timișoara p. 76

Most often, it is considered that the general liquidity reflects a favorable, good situation, if it has values between [1,2 ÷ 2] its minimum limit being 1[19].

**2. The reduced liquidity ratio** expresses the ability of the company to meet its short-term obligations on those current assets that can be converted quickly into cash, thereby eliminating the influence of the liquidity of the stocks.

As calculation methods, the reduced liquidity ratio can be determined in two ways:

- by the difference between the stocks (S) and current assets (CA) and then dividing the value thus obtained at the value of current liabilities (CL): $RLR = CA - \frac{S}{CL}$
- by the ratio of receivables (Re) and liquid assets (Lqa) to average current liabilities (CL): $RLR = Re - \frac{Avb}{CL}$

**3. Immediate liquidity** describes the ability of a company to pay its average current liabilities (CL) only from its existing liquid assets (Lqa) $RLI = \frac{Lqa}{CL}$

*Maintaining a company's financial balance consists in* ***correlating*** *the liquidity of assets (needs) with the chargeability of debts (resources).*

## CONCLUSIONS

Balance accompanies the economic and social life of an entity, which is stable and temporary. That is, the state of harmony and stability of the relations of the elements of structure is not given once and for all.

We can say that the overall economic balance exists when production, distribution, circulation, and consumption are determined in terms of volume and structure so that there is a full correlation between the needs and resources of material production, the movement of material goods and money, the need for financial and currency resources and the possibility of obtaining them, all of which, given the full use of the workforce and the guarantee of a certain quality of life.

It follows that the overall economic balance is achieved in the form of material, monetary, financial and currency, and workforce balance.

Identifying the ways to take action to ensure the balance between the resources deployed and how a company uses them is the key objective of financial analysis, which, based on balance sheet data.

The financial balance is assessed by comparing the degree of liquidity of the assets with the degree of chargeability of the liabilities, and and for carrying out this analysis can be used as tools: working capital, need for working capital, treasury and net position.

The consistent achievement of an entity's major objective – the maximization of its property value (increasing net assets, shareholders' assets) can only take place under the conditions of a profitable activity and maintaining financial balance.

[19] Sabău, Crăciun Nagy, Cristina Mihaela. Uher, Marina.(2015) „Contabilitatea reorganizării și lichidării întreprinderii,", Editura Eurostampa, Timișoara, p. 143

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