THE BAROMETER OF INSOLVENCY FOR ROMANIAN AGRICULTURAL COMPANIES

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Abstract: The fear sensed by the Romanian managers in the field of agriculture, the fear to declare a state of insolvency, represents the main reason for the increase in the number of bankruptcy cases within the Romanian market, the majority of these companies entering straight into bankruptcy procedures. Insolvency is not yet regarded by managers as a way for the company to recover, this being the consequence of a lack in a certain culture of insolvency, a culture that the managers in the other European have long possessed. For this very reason, the delay in declaring a state of insolvency is translated, in most cases, straight into a state of bankruptcy. The difficulties of companies are signalled by certain indicators, and if these are not identified in due time, the difficulties can be heightened by the slow reaction of the managers, who play a major role in assessing the difficulties as well as repairing the damage in case of unfavourable situations. Simultaneously, the the attention was focused on initiating a state of alertness, clearly stating the facts affecting the continuation of the business, the choices of the company when payments are ceased, but it intends to continue its activities, as well as the consequences of declaring a state of insolvency. Being aware of the risks, action can be taken for designing the adequate strategy of prevention and control of risk factors, and to undo, as much as possible, the damage already done.

Keywords: : insolvency, Profit and Loss Account, turnover, assets, risk

Introduction

Insolvency represents the lack of financial funds for paying the companys' commercial and fiscal debts. Insolvency implies insufficient funds to cover the debtor's contingent debts. There are three possible options for a company in a state of insolvency: voluntary restructuring, judicial restructuring and bankruptcy. Each of these implies a specific approach, with different economic and legal implications. The consequences of a state of insolvency are of a material order, through the costs involved by the measures that need to be taken, and also of a psychological order, involving all the "actors" related to the company's activity: creditors, managers, stuff. The diagnosis provides a realistic vision of the company's situation and of the process of degradation to the decision-makers, being the starting point in formulating the plan for reorganization or liquidation. Regarding the financial-accounting diagnosis, Peter Druker noted: "it is an important available to the company manager, likely to help him understand the past and present of the business, as well as to offer direction to his present and future actions. An efficient manager has to allocate about 50% of his time to diagnosis".

Material and method

Our approach aims at clarifying the concept of insolvency. Our research focused on synthesizing the notions comprised by specialty literature. In order to elaborate the study we have analyzed the data comprised by the financial statements of the evaluated company, along a 3 – year period, in order to detect the appearance of insolvency caused by objective as well as subjective factors

Results and discussions

In preparing this analysis, we have taken into consideration the economic and financial situation of the analyzed company, starting from the idea that they reflect an accurate and complete image of the economic activity undertaken by the company. The financial-accounting diagnosis plays the role of „centre of synthesis" in giving insight to management decisions, so that the final result is represented by performance. For any manager, the diagnosis of the entity he manages represents the action through which the „health" of the company is evaluated. Through identifying the internal and external factors related to the tendency of evolution and through the estimation of the impact of their modification, strong and weak points in the company's activity are established. In preparing the present analysis, we have taken into consideration the economic and financial situation of the company we had in view, starting from the idea that they reflect an accurate and complete image of the company's activity. The case study was undertaken at SC C&C Harlau, Iasi. In the period we analyzed we recorded a downward trend in turnover (with the exception of the year 2012, when it increased from 2.266.989 lei in 2011 to 2.318.249 lei), it reaches the minimum point of 1.530.813 lei in 2013. This evolution of the turnover takes place against the background of the diminishing, year to year, of the revenues obtained from selling merchandise, as well as the revenue of the production. Through the Profit and Loss Account, between 2011 and 2012, we followed the activity of exploitation and financial activity. The exploitation activity presents a major importance in the framework of the Profit and Loss Account, irrespective of the particularities of the activity.

As far as the situation of the company SC C&C Harlau, Iaşi, we met a fluctuating evolution, so that in the year 2011 the profit incurred was 167,590 lei, with a decline beginning in 2012, when the recorded loss reached the level of 10,921 lei, without returning to a profitable situation for the rest of the analyzed period. The total amount of loss is 214,661 lei, with a minimum in 2013, of 117,058 lei. The revenue from the exploitation drops continuously in the analyzed period, with the exception of the year 2012, when a slight improvement is recorded, mainly consisting in income from the sales of production and income related to sales of merchandise.

The largest percentage in exploitation revenue is represented by the sale of merchandise (more than 60%), followed by sold production, which clearly indicates the fact that the commercial activity undertaken by the company was predominant. The sold production amounted to more than 39%. The exploitation expenses represent the total amount of expenses generated by the activity of the analyzed company and exhibit a pattern of evolution that is similar to exploitation revenues, following, like the latter, a fluctuating trend. One can observe that along the entire period that was analyzed the largest percentage of exploitation expenses is represented by the expenses on merchandise, which is a natural thing if we take into account the fact that the basic activity was commerce (47.25% in 2011 to 39.00% in 2013).

Alongside with these expenses with merchandise, expenses with raw materials and other materials are also recorded (from 18.72 in 2011 to 19.18 in 2013), expenses with energy and water, expenses with taxes, personnel, depreciation and other various expenses, amounting to 4,988,301 lei. The revenues are slightly higher than the costs, with the result of the exploitation signalling profit, but in the last 3 years the total amount of exploitation expenses occasioned by the activity was higher than revenues, generating negative results in this period. Thus, given the rise in the costs related to raw materials, production costs also rise, while the sale price remains the same, so that the exploitation activity starts to become unprofitable. Financial income amounts to a low percentage in the total revenue obtained by the company, structurally consisting in income generated by the differences in exchanging currency, income from discounts and income from bank interests, their total being 207,787 lei. The financial expenses record considerable amounts, especially during the first 2 years of the period that was analyzed. The evolution of these expenses follow a fluctuating trajectory, in accordance with the income from this category, and structurally they represent expenses with the differences in currency exchange and expenses with bank interests. As one can notice in the evolution of Profit and Loss Account, the fact that significant fluctuations were recorded was caused by the high level of fluctuations in the field of currency exchange, translated into significant losses in the financial activity. These losses were recorded as a consequence of reimbursing the bank loans and the corresponding bank interests. With the exception of the year 2012, when the company had a positive net result, its activity was not profitable, with significant losses each year, with a peak in 2013 – 116,524 lei. Then, we moved to the analysis of liabilities based in structure rates, which give information regarding the financial policies of companies and highlight various aspects concerning their stability and autonomy.

The rate of financial stability points out the percentage of permanent resources in total liabilities. In the specialty papers, various authors mention the matter of inclusion – or the lack thereof – of provisions for risks and expenses in the company's own capital. The risks and expenses provisions correspond to an increase of short- or long-term liabilities. Being considered "probable debts" covering a real risk, in the balance sheet, they are situated between own assets and debts. The size of the rate of financial autonomy depends on the financial policy adopted, the efficiency of the decisions taken and the profitability of the enterprise.

The rate of financial stability reflects the connection between the capitals available for the company permanently and the total amount of assets, and is significantly below the optimum level, to the extent that is even recorded negative values in the last year. This evolution is caused by the fact that along the entire period the reported results recorded negative values (losses). This means a diminishing of the financial stability and security of the company, caused by the decrease of capital and the increase of losses. The rate of global financial autonomy represents the extent to which payment obligations can be met by the company. It has negative values (caused by having finished the financial exercise with losses that, cumulated, consumed the whole capital of the company), displaying a high risk of insolvency. The rate of global debt shows an increase, getting as high as 153% in 2011. It is a significant value, taking into account the maximum acceptable level is 66%. It is clear that the company's own funds are not capable to support its activity. In the following table (Fig. 1) we present the values recorded by some of the structural rates of liabilities:

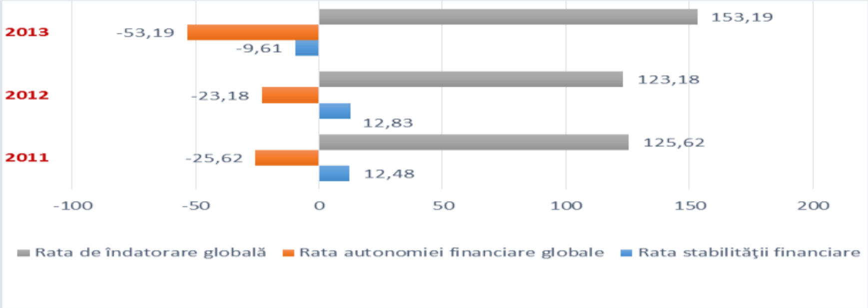

Fig. 1. Ratele de structura ale pasivului

The current activity of the agricultural company involves using the mobile and fixed assets. The rates concerning the company's activity reflect the connection between the revenue (or elements of the revenue) and the assets needed by the current activity, measuring the efficiency of their management. The evolution of these rates and the comparisons with the values obtained by companies in the same field of activity can offer information regarding the posible difficulties or opportunities.

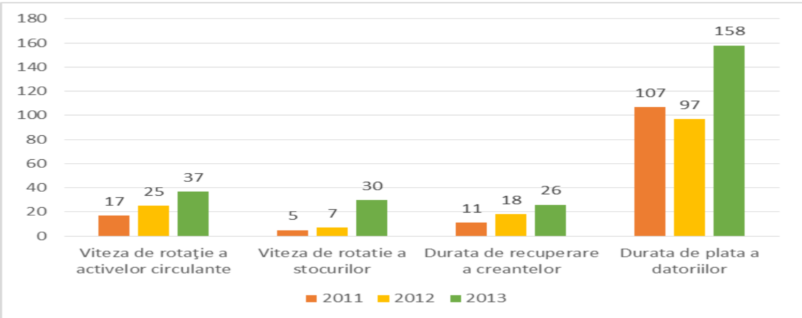

Fig. 2 Management analysis

The inventory turnover rate represents the number of days necessary for the stock to go through different phases of supply, production and sale. An acceleration of the inventory turnover means an increase in the efficiency of their use. In this particular case, it is accelerated, between 5 and 30 days, taking into account the fact that the minimum value that ensures an acceptable efficiency of stock management is around 45 days. The recovery time varies between 11 and 46 days, in the period 2011 – 2012, so in this case the recovery time is medium (between 10 and 30 days). One aspect has to be mentioned, though: the company has to recover debts from clients that entered the procedures for bankrupcy, as we intend to show in the following. The time needed for paying off debts is fluctuating, reaching values that are rather high, at the end of 2013 being 158 days, as opposed to the 30 days – the amount of time that is considered to be optimum. These values suggest impossibility in paying off debts, in this case, mainly debts to suppliers. To have an image that is as complex as possible, we analyse the ratio claims – debts. Looking at this ratio, we notice that the sum of debts is significantly bigger than the sum of claims, which is translated into difficulties with payment.

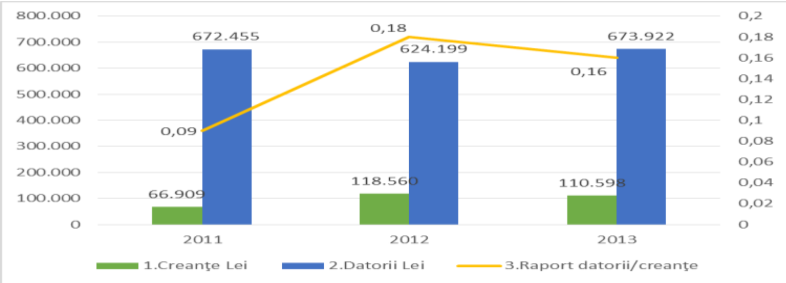

Fig. 3 The ratio claims - debts

Between 2011 and 2013, for the company we analyzed, the indicators of financial balance are presented in the following chart:

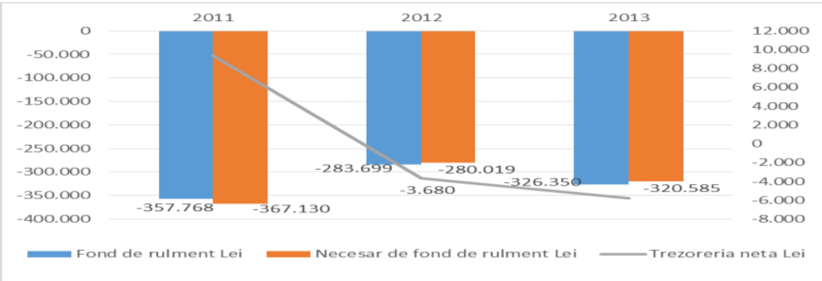

Fig. 4 The indicators of financial balance

Based on the analysis, one can predict an unfavourable situation, represented by a negative working capital along the entire period with values fluctuating towards the negative, which means a state of financial unbalance. This situation is caused by the permanent capital dropping year after year, even recording negative values towards the end of the time frame. The working capital requirement represents the part of current assets that needs to be funded from permanent, stable sources, and gets more and more values. This happens as a result of the increase in company's debts, beyond the level of current assets. The net cash accurately reflects the financial balance of companies, through comparing the working capital requirement and the necessary turnover, recording negative values throughout the entire analyzed period. Against the background of increasingly bigger short-term debts, compared to the level of permanent capital, it registers an extremely large deficit. In order to strengthen the overall picture we envisioned regarding the analysed company, we have calculated the indicators of liquidity analysis, management and financial balance, according to the chart below.In this particular case, general liquidity is below 1 throughout the entire period 2011 – 2013, a fact denoting the company's weakening possibilities to handle its payment obligations. The liquidity ratio is lower than the minimum of 0.8, being beyond the safety framework.

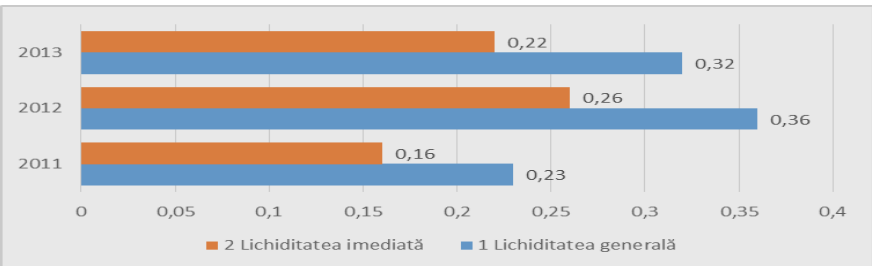

Fig. 5 The analysis of liquidity

Conclusions

A series of factors contributed to the failure to the economic failure of the company: management incompetence and management errors (60%); the unfavourable evolution of the market (20%); other causes (20%). The main cause of decline in the case of our company is to be found in the processes linked to management and market information. That is why we consider it a necessity for the management to identify in due time the signals of a possible deterioration of the financial situation, such as: obtaining negative financial results; negative turnover; the impossibility of repaying loans according to their maturity; the bankruptcy of suppliers or of clients that are important to the company.

From the economic and financial analyses discussed above one can clearly notice the fact that the assets of the company were characterized by a shortage of liquidity, throughout the entire period. At the same time, one can notice the fact that the activity of the company is characterized by constant losses, so that the seeds of insolvency can be observed even from the very beginning of the analyzed period. As a result of our analysis, we can underline the existence of a faulty management at the level of the agricultural company, caused by precarious management of assets, as well as the lack of measures meant to repair the company's financial status. All of these eventually led to more debts. Once the degree of debt increased, the risk of insolvency also rose for the agricultural company.

The reduced possibilities of facing payment obligations and supporting the activity using its own funds caused the company to have negative values along the entire time frame, which translates into a high risk of insolvency. The difficulties with recovering debts led to a deterioration of liquidities, so the financial balance was influenced unfavourably, ending with stopping the payments altogether. The accumulation of significant debts, situated way above the level of assets, presented the company with the impossibility to pay its debts.

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