PRACTICAL SOLUTIONS FOR SOLVING THE NEGATIVE NET SITUATION IN THE CASE OF INDUSTRIAL ENTERPRISES IN ROMANIA

Cătălin GHEORGHE
Transilvania University of Brasov, Romania

Abstract. Restoring the financial balance is a frequent topic in industrial enterprises, especially in the economic crisis. Widespread reduced sales amid employment of large debts to finance investments and operating cycle alongside other influence factors can lead to the development of such a situation. Specialized literature recommends restoring the financial balance through a set of measures. Most of them, however, have only a theoretical nature, as their implementation as such in the real economy does not lead to results. This article proposes a selection of these solutions, from the practical content perspective.

Keywords: net situation, indicator, negative case, financial balance, industrial enterprise

1. Introduction

Concept commonly seen in financial theory and practice, the financial balance occurs in connection with public or private funds. It involves the harmonization of the cash input and output flows, in time, dimension and volume [7, 13, 14]. This state, as it is defined by some authors, is dynamic, meaning that it changes over time, depending on the evolution of the financing needs and sources of funding. The financing requirement is determined by the cycle of exploitation on the one hand and the dividends, purchases of fixed assets respectively, on the other hand. Sources for covering these financial needs can be borrowed or rented in the financial markets.

Whereas the financial balance is a condition prior to obtaining the profit, it is necessary to study the conditions of creation and maintenance [1, 13]. Specialization literature provides the possibility to determine the static and dynamic balance. Static balance appears as a result established between the availability of money, receivables, on the one hand and short-term obligations, on the other hand. The information must be supplemented by the component from the upper level of the financial balance sheet that makes the connection between the purchase of fixed assets and the sources available to the undertaking for a period longer than one year. In this way, there is obtained the information on the liquidity and solvency of the enterprise at a specific time.

Studying the dynamics of the financial balance involves the making of tools which compare the needs and financial resources over several consecutive periods. This will determine the variance of the financial balance, providing the financial information on the specific conditions that have led to its consolidation, maintenance or damage. The main research tools, static or dynamic, for the financial balance are: financial balance metrics, the financing board and cash-flow projections. The category of financial balance metrics includes: net situation (assets), revolving fund, revolving fund requirements, net treasury and cash-flow [2, 12].

2. The position of the net situation in the category of financial balance metrics

The financial balance sheet is made on the principles of liquidity, chargeability, and solvency. Its use is aimed at assessing the company's solvency and financial balance. The necessary data is taken from the financial analysis of the balance sheet (Table 1). Starting from this form of balance sheet, the financial balance metrics are built with specific content. Only by establishing and providing a related interpretation thereof there can be conveyed the overall financial balance of the company. This paper analyzes the net situation, one of the financial balance metrics proposed in the specialization literature.

The net situation or net assets (NS) are determined as the difference between the total assets (excluding artificial asset items) and total debt contracted. This form reflects the expression of an enterprise asset value upon the date of the financial year closure.

$$NS = \text{Total assets} - \text{Total liabilities} \qquad (1)$$

The metric highlights the amounts that will be returned to the owners of the enterprise in the event of liquidation, i.e. the extent to which the hypothetical transfer of assets, upon establishing the metric, ensures liquidity at an appropriate balance of their net worth. The value of this metric represents an interest for the shareholders of the company, who want to know the value that they possess and lenders for which the net asset is their claims pledge [11].

Table 1. Balance sheet structure

ASSETS = NEEDS		LIABILITIES = EQUITY	
FUNCTION OF INVESTING	Gross fixed asset	Equity Depreciation and provisions Financial liabilities	FUNCTION OF INVESTING
OPERATING FUNCTION	Operating assets Current assets outside operation Assets of treasury	Operating debts Debts outside of operation Liabilities of treasury	OPERATING FUNCTION

3. The negative net situation in the industrial enterprise

Based on the relationship of determination previously set, the following situations may be encountered:

a) NS > 0 $\Rightarrow$ Total assets > Total debts

In this situation the metric reflects a proper economic management of the enterprise. The sources of growth of the metric are the net income and other items from previous financial years' accumulations. Increasing the net situation indicates a fundamental objective of financial management to maximize the enterprise value:

$$NS_T > NS_{T-1}, \quad (2)$$

where T is the current period, and is T-1 the previous period.

b) NS = 0 $\Rightarrow$ Total assets = Total debts

The situation involves a volume of debts to the sum of fixed assets and current assets of the undertaking, a situation which is rarely seen in practice.

c) NS < 0 $\Rightarrow$ Total assets < Total debts

This case is the subject of this article. In this situation, the total debts incurred by the enterprise have surpassed the real asset value. Theoretically, this is the consequence of concluding the current year or the financial years with loss. The uncovered part of the debts owed by the creditor remains as a result of taking on the risk of insolvency of the undertaking. The negative value of net situation highlights a pre-bankruptcy situation, but which may not be installed in a very short period of time [4]. There are signals that should not be neglected by the financial manager, for the period leading up, the most important being [5]:

- the reduction of profit;
- value decline in other metrics;
- increasing treasury deficits;
- shift from profit to loss;
- gradual capital consumption and others.

Specialized literature recommends reversing the direction of the inequality to achieve the fundamental goal of the enterprise [7, 11]. For this purpose the directions of action, mathematically possible, may be: maximizing the total assets and/or total debt minimization. Next there will be reviewed the theoretical and practical content of each possible solution. To this end, the balance sheet assets were grouped in the Table 2.

Table 2. Balance sheet assets

ASSETS	LIABILITIES
Fixed assets:	Shareholder's equity
- Intangible assets	Debts with maturity term over 1 year
- Tangible assets	Debts with maturity term up to 1 year:
- Financial assets	- suppliers
Current assets:	- creditors
- Stocks	- employees
- Receivables	- state
- Financial investments on short term	- other debts with maturity term up to 1 year
- Petty cash and bank accounts	

3.1. Maximizing the total assets

It comes down to maximizing the current assets (corporeal, non-corporeal and financial assets) and / or the circulating assets (inventories, receivables, short-term investments and availability). There will be examined in turn the possible solutions and practical content.

Increasing non-corporeal assets may occur as a solution with insignificant practical results, because their share in the total assets of the industrial enterprises of Romania is very low, in many cases it is zero. The accumulation of licenses, patents, amid a business development of the activity of the company, results in a situation opposite to the one analyzed. Proprietary research activity can lead to obtaining patents, but few industrial companies in Romania can finance research teams from their own resources. The Romanian Government's contribution to financing such activities is extremely low [3]. Given these arguments, the solution of growing non-corporeal assets appears to have a strong theoretical nature.

Corporeal assets have typically the largest share in total assets in industrial enterprises in Romania. Therefore, any practical solution identified at the level of these asset items has a major impact on restoring the financial balance. Theoretical ways to increase corporeal assets (land, buildings, etc.) are:

- Make investments through which there are capitalized the financial resources available and oriented towards productive items.

This solution commonly found in the specialization literature implies either the existence of available capital or the lending ability from the exogenous environment. However, the negative net situation is accompanied by a negative value of equity as shown in the following relationship. In such a formulation, the metric shows the acute shortage of financial resources belonging to the enterprise [13].

$$\begin{aligned} NS = \text{Equity} - \text{Investment grants} - \\ - \text{Provisions covered} \end{aligned} \quad (3)$$

The relationship disregards allowances for investments and regulated provisions as they are not assimilated to equity. Including provisions in the equity category seems justified, according to some authors, as their establishment allows taking into consideration that in nature they have a character of reserve and can be treated as equity. However, the provisions in question do not cover the actual risk and the future, but are reserves, and must be subject to tax subsequently. They will be reintegrated into the taxable income in excess of the provisions made in relation to actual risk, in which case the company will incur a tax liability. It can be considered that provisions that do not cover strictly real and future risks (and are not intended to be consumed in the short term) may be treated as permanent equity. Unlike equity, the net situation is more restrictive as it excludes subsidies investments and regulated allowances, elements which are likely to be encumbered by debt or hire tax claims. Therefore such a solution is only theoretical. Contracting debts, as we shall see below, require the consent of creditors. The decision to grant a loan, regardless of the type, involves knowledge, in most cases, an analysis of the borrower. Amid the existence of high debt and the impossibility of their coverage, as stated above, this solution has a strong theoretical character.

Revaluation of fixed assets involves harmonizing their value to inflation, the utility, condition and the market price when the carrying amount differs from the fair value. In accordance with accounting regulations, in accordance with Directive IV of the European Economic Community approved by OMPF 3055/2009 and the accounting regulations in accordance with the Seventh Directive of the European Economic Community, companies may revalue corporeal assets (buildings, land and so on) [9]. Revaluation of corporeal assets is usually at the end of the financial year, so they are shown in the accounts at the fair value. The revaluation result may be an increase or decrease to net accounting value, and will be reflected in the financial statements for that year [10].

Increasing the financial assets involves increasing the number of shares in the capital to create or develop the capital of other companies or increase the portfolio of securities held in comparison to the time of their acquisition. This reflects important aspects arising from the fact that the securities are characterized by high liquidity and are therefore used to obtain cash, in the steps leading to the installation of the net negative situation. That is why the solution has low practical content. In the category of current assets, stocks have the highest percentage. Unlike corporeal assets, current assets have greater liquidity providing the enterprises the possibility to perform an operative cover of the debt from retrieving debts, carrying cash investments and preserving liquid reserves to bank accounts. Choosing the level of current assets, and how their financed, is linked to the attitude of the management on optimizing the risk- return relationship.

The level of current assets is based primarily on anticipated sales. Thus, the increase in current assets under a constant level of production and sales leads to a decrease in the yield of total assets held by the company. Otherwise, a low level of assets leads to higher profitability, but also to a higher degree of risk. The ratio between sales and the current assets is specific to each company. According to this ratio, there may be identified the management policies of the operating cycle. An increase in current assets can mean:

- Increasing the workload, situation contrary to that examined in this study, so the solution is only theoretical;
- Changing the management policy in the short term; shifting from an offensive policy to a defensive one, characterized by larger stocks. In this case, there will be the issue of financing the additional inventory from equity or loans. Thus, one returns to the situation encountered before.

Following the increase of liquidity, there come the receivables established in the current and prior periods. Tracking their eventual increase, there can be concluded that there are given to customers longer terms of payment and / or increase the volume. Such an approach cannot be accepted in a proper management of the business assets. It is known that by a good short-term financial planning, the company must obtain an average term of debt collection as low as possible, less than the time required extinguishing medium short-term liabilities. In this way you can get the funds raised in short-term, with favourable effects on capital structure and financing costs.

Short-term investments and availability are the most liquid assets. Until the advent of the net negative situation, a signal that the financial manager should consider is to increase the cash deficits. Therefore any increase in the two balance sheets, although desirable, is difficult to obtain.

3.2. Minimizing the total debts

Other way to solve negative net situation is reducing debts greater than one year or the short-term (less than one year). There shall be followed the same approach as in Section 3.1. Reducing the relief on a term exceeding one year would mean immediate payment of debts contracted for investing. The solution remains only theoretical because acceptance of such solutions rises on the issue of liquidity necessary to pay debts and replace them with other sources. In the absence of own financial sources (negative equity) and those borrowed (bank loans, bonds and leases) the only practical solution is again the capital contribution of the shareholders. The capital increase will raise concerns among shareholders, because not everyone will decide to subscribe to the capital increase. Another problem to be overcome is related to the amount that each shareholder must attend the re-launch.

Payables consist of amounts due to suppliers, creditors, employees, state and other short-term lenders. As proceeded up till now, there will be examined each component in reducing them.

Amounts owed to suppliers for their contribution to achieving the production could theoretically be reduced by cash or decrease the amount of these purchases their quantities purchased with deferred payment. Both solutions does not be seem to be accepted from a practical standpoint because it would contribute to the elimination of free sources of funding (source drawn) and increased financing costs.

Short-term debts to creditors are generated by their participation in financing the operation. Reducing them, while theoretically possible, determine their replacement with other equity issue. It comes to a situation described above.

Liabilities to employees are characterized by a greater flexibility when considering the issue of reducing them. Solutions to reduce these costs are often found in the real economy: the discharging personal or reducing the average hourly wage [8]. There should be emphasized that the two solutions are not generally available. Moreover, according to the author, discharging the personnel beyond the legal occupational provisions should be justified in economic terms. Analysis of personnel costs will be correlated with the average annual labor productivity. Labor productivity and the average wage represent an integral part of the company's wage policy. Bringing forward the growth of the average wage by average labor productivity leads to savings on the wage bills, which reflect positively on the company's activity.

Debts to the state are generated by the application of the business enterprise tax. Taxes owed by businesses represent a fundamental source of income to the state budget. Establishment of public revenues and expenditures are based on the rules and procedures established by law, by which there are set the responsibilities, duties and skills. Deferred payment of debts to the state budget it to be analyzed according to the actual cost of the amounts paid to state with delay. Thus, the amount due the state budget has added additional costs due to interest and penalties.

4. Conclusion

Specialized literature recommends restoring the financial balance to relaunch a business activity. The net situation is a key metric of the financial balance board. The solutions proposed by the literature are generally theoretical. Only a few of these can be applied in the real economic environment with positive results. Among these, there should be noted the cash contribution of shareholders or resuming the operating cycle and restoring the company's profitability.

References

1. Bran, P. (1997) *Finanțele întreprinderii* (*Finance Company*). Editura Economică, ISBN 9739648779, Bucharest (in Romanian)
2. Coelli, T.J., Rao, P.D.S., O'Donnell, C.J., Battese, G.E. (2005) *An Introduction to Efficiency and Productivity Analysis*. 2nd ed., Springer, ISBN 978-0387-24265-1
3. Gheorghe, C. (2011) *Above Purposes of the Bankruptcy Legislation in Romania During Financial Crisis.* WSEAS International Conferences, Transylvania University of Brasov, Romania
4. Gheorghe, C. (2010) *Insolvency – Solution for the Activity Continuation of the Companies Seriously Affected by the Crisis.* RECENT, ISBN 1582-0246, vol. 11, no. 3(30), p. 197-207, Brasov, Romania
5. Gheorghe, C. (2011) *Monitoring the Long Term Debt Level of Companies*. Seventh International Conference "Mechanics and Machine Elements", Sofia, Bulgaria
6. Helfert, A.E. (2001) *Financial Analysis Tools and Techniques. A Guide for Managers.* McGraw Hill Professional, ISBN 9780071378345
7. Hubbard, R.G. (1990) *Asymmetric Information, Corporate Finance, and Investment*. University of Chicago Press
8. Isfanescu, A., Robu, V., Hristea, A.M., Vasilescu, C. (2002) *Analiza economico-financiară* (*Economic and Financial Analysis*). Editura ASE, ISBN 9735940833, Bucharest, Romania (in Romanian)
9. Romanian Ministry of Public Finance. *ORDER 3055 from 2009 for Approval of Accounting Regulations Compliant with European Directives*. Official Journal of Romania, No. 766 from 10.11.2009
10. Romanian Ministry of Economy and Finance. *ORDER 3471 from 2008 for Approval Methodological Norms regarding the Revaluation and Depreciation of Fixed Assets Public Institutions Patrimony*. Official Journal of Romania, No. 835 from 11.12.2008
11. Stancu, I. (2007) *Finanțe* (*Finance*). Editura Economică, ISBN 978-973-709-320-2, Bucharest, Romania (in Romanian)
12. Toma, M., Alexandru, F. (2003) *Finanțe şi gestiune financiară de întreprindere* (*Finance and Financial Management Enterprise*). Editura Economică, ISBN 9735907712, Bucharest, Romania (in Romanian)
13. Văcărel, I. (coord.) (2007) *Finanțe publice* (*Public Finance*). Sixth Edition. Editura Didactica şi Pedagogică, ISBN 973-30-1998-5, Bucharest, Romania (in Romanian)
14. Vintilă, G. (2010) *Gestiunea financiară a întreprinderii* (*Financial Management of the Enterprise*). Editura Didactica şi Pedagogică, ISBN 978-973-30-2721-8, Bucharest, Romania (in Romanian)

Received in January 2014