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ON CORPORATIONS LIQUIDITY

Wan Li, MBA student, Buhayeu A., PhD, professor,
Yermachenko O., senior lecturer
Vitebsk State Technological University,
Vitebsk, Belarus

The key link in financial diagnostics is the solvency characteristics of the economic entity.

Liquidity is one of the most important factors affecting the price of financial assets, but liquidity has different meanings in different contexts. In our opinion the meaning of liquidity mainly includes three categories.

One is to express the strength of the liquidity of assets. Liquidity is the ability of an enterprise to convert its assets into cash in order to fulfill its obligations, ideally reducing transaction costs as much as possible. For example, we say that the liquidity of 10-year bonds is good, which means that the market volume of 10-year bonds is very large, and we can sell the bonds at a reasonable market price. And we say that seven-year bonds are illiquid, which means that it is difficult for us to sell such bonds quickly at a reasonable market price. If we want to sell a larger amount at one time, it may lower the market price of the bond. It takes a discount to sell.

The second is to express the solvency of the enterprise. If the cash flow of the enterprise is abundant or has strong liquidity and solvency, it means that the liquidity of the enterprise is better and vice versa. In general, we can measure the solvency and liquidity of an enterprise through its financial statements, such as using the current ratio (current assets / current liabilities) to measure the short-term solvency of an enterprise.

The third is to express the macro concept of money supply. Liquidity in macro sense is divided into broad liquidity and narrow liquidity. Among them, narrow liquidity refers to the capital situation in the interbank market, reflecting the amount of funds available in the banking system. In general, we can observe broad liquidity by M2 social finance and other indicators.

The several authors substantiate the limited applicability of solvency ratios proposed by other scientists and specialists, as well as the usability of those indicators for future periods.The several authors approach to building a model for assessing the solvency of a company in a future period; this approach is based on a comparison of predicted cash flows.

The difference in the methods of assessing solvency lies only in the composition of the ratios used. More sophisticated solvency assessment models may include rating systems and a weight component.

It is important to assess the solvency of the enterprise not in the past, but in the future.

REFERENCE

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