

## METHODOLOGY OF CORPORATE FINANCIAL DIAGNOSTICS IN THE PERIOD OF A CRISIS

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**Abstract:** The article is devoted to corporate financial diagnostics' peculiarities in the context of ideas about organizational crises. The economic signs of a crisis enterprise are considered in conjunction with the critical signs of a crisis: a threat to priority goals, suddenness, and lack of time for making anti-crisis decisions. The study of scientific ideas about the crisis, in conjunction with the enterprise's financial characteristics, is a necessary stage in the formation of the methodology of corporate financial diagnostics.

**Keywords:** Crisis, Enterprise analysis, Financial condition, Financial diagnostics, Financial management.

### 1 Introduction

Corporate financial diagnostics is an independent and relatively poorly studied area of financial analysis of an enterprise [41]. The term 'corporate financial diagnostics' is rarely used. The closest to it in meaning is the 'corporate financial health assessment,' which is associated with forecasting financial difficulties. Let us consider the diagnosis of the financial activity of an enterprise as a science of financial management. Other authors have studied the problems of corporate financial diagnostics [8]. Still, they did not always manage to draw a clear line between financial diagnostics and analysis of an enterprise's financial condition. Some authors have defined the content of corporate financial diagnostics as establishing the stage at which the company is at the moment and analyzing the company's financial condition [13].

The criterion for assessing an enterprise's financial condition for financial diagnostics is some "proper" or "normal" financial condition, which in diagnostics serves as target states. Financial diagnostics involves studying the state of the object being diagnosed, as well as deviations from its normal state, the causes, and duration of such deviations [41]. Signs of the proper financial condition of an enterprise can be established based on comparison with the requirements of regulatory documents, with conditionally best values, with data from other enterprises, and the values of similar indicators of the analyzed enterprise for different periods [12, 13]. However, the above criteria do not bring us closer to understanding the features of financial diagnostics.

More valuable, from our point of view, is studying the essence of the target financial condition [1]. Note that we can talk not only about the "proper" financial condition. Financial diagnostics can be aimed at recognizing the financial signs of an enterprise crisis. In this case, the diagnosis is associated with identifying signs of financial difficulties by analogy with the diagnosis of diseases in medicine. The second approach essentially brings corporate financial diagnostics closer to assessing a firm's financial health, enriching its theoretical and methodological base [3].

However, the concept of "crisis" has no unambiguous definition. Moreover, it cannot be called merely ambiguous. This term is applied to such a wide range of phenomena, so often and everywhere that the scientific justification of the corresponding definition becomes a challenging task. And at the same time, the study of the crisis's essence is necessary to establish a crisis's key financial signs [9].

### 2 Literature Review

There are two main mutually complementary approaches to defining a crisis as a scientific category: a crisis can be interpreted as a process (we will conventionally call this interpretation a dynamic one) and as a state (respectively, a static interpretation of a crisis) [22].

Often, a crisis is defined exclusively from a negative perspective, as a particular state of a complex system that threatens its further existence. The reason for the system's crisis state is considered an extreme aggravation of the contradictions existing in it [25]. The concept of "crisis" is applied exclusively to complex systems, the elements of which can be considered as "separate systems, united into a single whole following certain principles or interconnected by given relations" [4, 28, 45, 46]. An example of a complex system is, in particular, a socio-economic system - a set of resources with the obligatory and dominant participation of the human factor.

The objective characteristics of a crisis are as follows:

- 1) The crisis is a turning point in the unfolding sequence of events or actions (this feature is directly related to the etymology of the word "crisis") [8];
- 2) The nature of the crisis is a combination of circumstances giving rise to a new set of conditions [12];
- 3) The crisis poses a threat to the goals and objectives of the persons involved, and even if this threat is not realized (in parentheses, we note that the crisis is a rather unlikely event) [44];
- 4) A crisis requires urgent action on the part of its participants [1];
- 5) The crisis increases the lack of time of the persons involved [41];
- 6) In times of crisis, the information available to participants is usually inadequate [45, 46].

Features of the subjective perception of the crisis are five features:

- 1) Uncertainty in assessing a crisis and justifying alternative options for overcoming it [9];
- 2) Stress and anxiety among the participants in a crisis [11];
- 3) Weakening of control over the events taking place and their consequences [8];
- 4) Increased tension among participants in a crisis [10];
- 5) Changing the relationship of the persons involved [15].

Another characteristic of the signs of a crisis, which has received the most comprehensive recognition in the theory and practice of anti-crisis management, goes back to research on the specifics of a crisis in organizations [12]. According to this approach, the crisis's characteristic features are a surprise, threat, and lack of time for reaction. It is noteworthy that such signs as a threat and a lack of time to make anti-crisis decisions, one way or another, are present in many definitions of a crisis. The authors point to the threat to its existence and a severe lack of time as defining signs of the crisis conditions of the firm's existence.

Abruptness, on the other hand, is not always recognized as a relevant characteristic of a crisis [11]. In addition to the so-called sudden crises of organizations, smoldering crises are also considered in science. These types of crises have been developing for quite a long time and are not unexpected. At the same time, it cannot be denied that crises are difficult to diagnose. In exploring the specifics of corporate governance in emergencies, some problems elude observers, no matter how hard they try, and turn into strategic surprises [14, 27, 35]. In this regard, the point of view that the causes of the crisis are systemically linked, interrelated and interdependent, seems to be very interesting. Analyzing individual signs and causes of the crisis, it is impossible to get a complete picture of their systemic

impact as a rule [17]. That is why crises are so difficult to predict. Thus, characterizing the signs of a crisis, one can speak, at least, about the non-standard nature of the crisis situation, and often about non-standard and suddenness.

A broader interpretation of the crisis takes into account its possible positive consequences [15]. In this case, the crisis is seen as a process of transformation of a complex system. At the same time, the inevitability of this process is usually emphasized: as a result of accumulated contradictions, the system cannot exist in its previous form, and overcoming the crisis is a necessary condition for renewal. Applying the concept of "crisis" in a broad interpretation, the crisis is designated as "threat" and "opportunity" [16]. In economics, priority attention is paid to the broad interpretation of the crisis, which is usually used in conjunction with the concept of life cycles of socio-economic systems [3, 17]. In particular, anti-crisis management of socio-economic systems is based on two basic theoretical premises:

- It is believed that the existence of any socio-economic system is cyclical;
- The cycles of the existence of socio-economic systems are interconnected with crises;
- The crisis is a crucial stage in the development of any socio-economic system [18].

In this sense, the management of any socio-economic system can be anti-crisis [44].

### 3 Materials and Methods

The methodological basis of corporate financial diagnostics is formed by methods and models for forecasting corporate bankruptcy, which draw us to a wide range of financial signs of an enterprise crisis. Economic research devoted to diagnosing organizations' insolvency has been carried out for more than a decade, but, unfortunately, the question of priority signs of financial difficulties is still open. Empirical studies show that a variety of models for predicting financial insolvency are based on a firm's four basic characteristics: profit, leverage, liquidity, and size [4, 6].

Concerning corporate diagnostics procedures in general and financial diagnostics in particular, it should be noted that they hardly lend themselves to clear formalization. In a crisis, the usual mechanisms do not work or work ineffectively, and, therefore, diagnostics requires the use of non-standard approaches [19].

We have to reckon with the inadequacy of the available information about the enterprise in crisis. The old strategies and plans are not good; the tasks are new, the information that needs to be mastered and studied flows in a stream. Information overload threatens the firm. The suddenness and the likelihood of a major loss are understood hardly in the firm that there is a general panic threat.

At the same time, an enterprise crisis, like any crisis, is characterized by a lack of time for making anti-crisis decisions. In a financial sense, this means that the price of time for a crisis enterprise is the highest [18]. One of the essential features of the crisis and the subjective reaction is the factor of time. Time, as it's known, always has an economical price, which is especially significant during a crisis [20].

In other words, the temporary value of funds for a crisis enterprise increases, which, in turn, is reflected in the assessment of the present value of expected cash flows. This situation can be explained by the fact that the risks associated with the company increase in a crisis. Consequently, the discount rate also increases, the value of which, in particular, depends on the risk associated with the financial transaction. As a result, as can be assumed, investors' profitability and, consequently, the cost of financing increases, which reduces the investment opportunities of the enterprise and reduces its economic potential.

### 4 Results

An enterprise's crisis (crisis situation) is often defined precisely from the point of view of the threat to the priority goals of its development [22]. However, enterprise development's priority goals are interpreted very broadly and ambiguously, which will allow us to get a more comprehensive picture of the crisis situation. Any goals must be aligned with those of the stakeholders, as people may have goals, but not organizations [25]. If we talk about the goals of enterprise development from the point of view of stakeholders, two main approaches can be distinguished:

1) Maximizing the wealth of the owners. In this case, the priority indicator of the enterprise's proper state is the market value of equity capital (market capitalization of public companies), the steady decline of which is one of the most significant financial signs of the crisis [23].

2) Balance of stakeholders' interests, including shareholders and landlords, counterparties, personnel, regulatory bodies, public organizations, etc. The enterprise crisis threatens the interests of not only the owners but also other stakeholders. As a result, the conflict of interests of the stakeholders only aggravates. Still, during the crisis, the conflict of interests is resolved, and a new conflict of interests and new relationships arises [7, 21, 29, 45, 46].

Features, causes, and ways of overcoming the most significant conflicts in an organization's life, are investigated within the framework of the theory of agency relations, which is one of the fundamental financial concepts [23]. Priority attention, as a rule, is given to conflicts of interest between owners and top managers of the firm and owners and creditors. Company managers, acting as agents of both owners and creditors, are called upon to maintain a balance of their interests, taking into account other stakeholders' interests as much as possible [44]. However, ineffective management is the main cause of enterprise crises. According to some estimates, management errors account for more than 50% of the causes of all corporate crises. Simultaneously, the ineffectiveness of managerial decisions is often explained by managers' opportunistic behavior [25].

The main driver of the agency conflict, along with obstacles to collective action, is considered to be information asymmetry – the uneven distribution of information about an enterprise among stakeholders. The financial opacity of the company and, in particular, the insufficient level of transparency of financial reporting, which, as you know, is the main source of financial information about an economic entity, has a particularly detrimental effect on the development of the conflict [22]. Therefore, the analysis and assessment of financial statements' reliability and impartiality should be one of the most important stages of corporate financial diagnostics.

### 5 Discussion

Even when it comes to ineffective management, the causes of the enterprise crisis are so complex and numerous that it is a challenging task to predict the moment of its onset, nature, and consequences [26, 33, 34, 39]. In this regard, the crisis's diagnosis is of particular importance as the most important component of successful counteraction to its unfavorable consequences. Diagnostics should meet the following basic requirements: be based on reliable information, be objective, provide an opportunity to obtain unambiguous conclusions, and make the right decisions [30]. Special requirements should be met with respect to the diagnostic system: timeliness of recognition of crisis phenomena, reliability of the recognition result, continuity of the diagnostic process [1, 2, 3, 4, 5].

Analyzing these requirements, it should be emphasized that the diagnostics of the enterprise should be systematic. The system of corporate financial diagnostics is built, taking into account the laws of enterprise development [31, 47]. However, determining a

company's development stage is not easy, primarily because the number of parameters that can be used to characterize this stage is huge.

A systematic approach to solving this issue, as a rule, involves referring to the models of the organization's life cycle as models that set benchmarks for determining the requirements for the proper state, the logic of functioning, or determining the guidelines for the development of the organization [32]. The study of the peculiarities of corporate financial diagnostics in the context of an enterprise's life cycle seems to be a very promising scientific direction. However, one should not forget that the existence of the life cycle of organizations is often questioned. As some empirical studies show, most firms do not move adamantly from one stage of development to another in the traditional biological sense [37]. That is, in the life of an organization, there is more uncertainty than a determinism of development.

The main financial signs of a crisis of an enterprise, like any crisis system, should, it seems, be considered in conjunction with the key signs of a crisis [36, 38]. First of all, we are talking about the threat to the priority goals of the enterprise's development, the suddenness of the onset and (or) the non-standard of the crisis situation, and the lack of time for making anti-crisis decisions. Let us analyze the content of the main financial signs of a crisis enterprise based on this assumption.

In modern conditions, the required profitability does not always correspond to the investment risk. Firstly, equity capital prevails in the structure of enterprise financing [41]. In comparison with creditors, the owners of enterprises are forced to put up with high risks of capital loss with profitability lower than the loan payment.

Secondly, the traditional capital source is the current accounts payable, mostly not associated with fixed financial costs [24, 45]. An increase in the share of accounts payable in liabilities and a commensurate increase in the share of accounts receivable in assets is one of the characteristic financial signs of the crisis of Russian enterprises.

## 6 Conclusion

A crisis enterprise is characterized by a decrease in market value, existing in conditions of an acute conflict of stakeholders' interests [40]. This conflict's key role is usually played by managers, whose mistakes are one of the most significant causes of corporate crises. In a crisis, one has to reckon with such challenges as the suddenness and (or) non-standardness of the situation, as well as the lack of time for making management decisions, which, in particular, is reflected in the deterioration of the financial situation in the firm's activities and in the increased likelihood of bankruptcy. An adequate financial diagnostics system can prevent the development of a crisis situation and, in any case, is a necessary condition for its successful overcoming [26].

A healthy company can work for a long time and efficiently, but for this to be so. The responsible financier should continuously monitor all processes. It is necessary to permanently diagnose and permanently decide how to keep the company in working order [18].

Summarizing the above, we note that its duality explains the complexity of the crisis phenomenon: on the one hand, the crisis appears as a particular state of a complex system, on the other hand, as a corresponding process of its transformation. A crisis enterprise is not functioning well and needs urgent anti-crisis measures, while the reasons for its current state are numerous and unknown. In our opinion, static and dynamic interpretations of the crisis are not mutually exclusive. It is logical to assume that in the course of a crisis, the state of a complex system at any moment can be characterized by the word "crisis," which in this case will mean a crisis state of the system.

Consistently developing this point of view, we come to an essential conclusion regarding the methodology of corporate financial diagnostics: the practicality of further research of the economic signs of an enterprise crisis (crisis as a state), along with the study of the financial characteristics of enterprise crises in the context of its development (crisis as a process), not only intuitively obvious, but also deliberately due to the essence of the crisis phenomenon.

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#### Primary Paper Section: A

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