

A Brief Discussion about the Application of Financial Analysis in Financing Guarantee Risk Prevention

Chen Shuyi

Hohai University School of Business, 200 Jinling North Road, Xinbei District, Changzhou, Jiangsu, China
1343168702@qq.com

Keywords: Financing guarantee, financial analysis, risk prevention

Abstract: To develop guarantee industry is an important move to relieve financing difficulties for small and medium sized companies. However, guarantee industry faces great hazards that are more severe than those faced by financial institutions because of information asymmetry and minor companies' poor resistance against risks, and it remains a problem for the industry to identify and estimate potential risks. Financial analysis, as it partly reveals enterprises' operation status through relevant financial indicators, can provide references for guarantee decisions and help in effective prevention against financing guarantee risks.

1. Introduction

To solve minor companies' difficulties in financing, Chinese government encourages the establishment of financing guarantee agencies to back them up so that they can successfully get funds from financial institutions. But considering the lack of competitiveness, poor risk resistance as well as irregular management, small and medium-sized companies are likely to be driven out of the market, which poses financing guarantee risks as a significant problem for the guarantee industry to cope with by strengthening precaution measures. Through analysis of financial material, the problems and risks during enterprises' existence are brought to light, and financing guarantee institutions can adopt countermeasures in time.

2. Risks from the side of guaranteed companies

(1) Financial misstatement. Unobvious distinction between corporate capitals and private ones, confused management of assets, chaotic accounts, distorted financial information and other problems are commonly seen in many minor companies due to the absence of internal control system. As a result, financing guarantee agencies are interfered in decision and face great guarantee risks.

(2) Diversion of loans for other purposes. Many small and medium-sized enterprises would apply for loans that are meant for specific purposes according to financial institutions' requirements, but once the funds are approved and transferred to their accounts, they would fabricate transaction materials to divert these moneys for other purposes, which is beyond guarantee agencies to control.

(3) Malicious capital shift. For many minor companies, financial management is chaotic that there's no clear distinction between corporate capitals and personal ones, so that funds may flow arbitrarily in between and may be shifted to avoid debts once the business failed, leaving the liability to guarantee agencies.

(4) Business failure. SMEs usually have weak competitiveness and poor anti-risk capabilities, suffering higher risks of business failure, so it's at stake to endorse for them. That's why the compensation rates and losses of guarantee agencies are much higher than that of financial institutions such as banks.

(5) Dishonest collaterals and pledges. Some SMEs may disguise other parties' estate as their own to win endorsement from financing agencies, or use their properties repeatedly to apply for different mortgages or pledges, which increases the risks faced by guarantee agencies.

3. Financial analysis in pre-guarantee investigation

(1) Asset authenticity. Guarantee practitioners should strictly and meticulously check asset accounts from money funds, accounts receivables, inventories to fixed assets. Bank deposit should be checked with statements to ensure the consistency between book amount and actual figures; accounts receivables should be testified as existing by materials including confirmations and sales contract invoices; no less than 80% of total inventories should undergo examinations by category to ensure the consistency between book amount and physical stock; fixed assets should be checked to see whether depreciations are full. Besides, other items within asset accounts should also be reviewed to ensure proper and accurate revealing of enterprises' operation. Ultimately, their financial statements should be adjusted on the basis of corrected book value of reviewed assets.

(2) Liability authenticity. Liability authenticity analysis mainly focuses on implicit liabilities. Inventories, fixed assets and construction-in-process should be examined to check whether their practical values surpass book values, if so, there may exist off-book debts. Financing costs, management fees and other receivables should be examined to detect implicit expenditures, if so, they may be used to pay debts or interests, in other words, the enterprise has concealed liabilities.

(3) Income authenticity. Comparisons and analysis should be conducted between out store tables and sales contracts, sales contracts and sales invoices, sales invoices and tax vouchers, selling expenses and sales proceeds, as well as among sales funds recoup, accounts receivables and sales proceeds. What's more, the performance of sales proceeds in the past three consecutive years should be observed to ensure honest statements.

(4) Collateral and pledge authenticity. Collaterals and pledges should be checked to see whether they are registered on book, whether the acquisition of them has undergone complete legal procedures. As for fixed assets, practitioners should conduct field observations to ensure their existences and to check if the warrants belong to inspected enterprises. Through consultation with associated departments, all the collaterals and pledges should be examined to avoid multiple mortgages or pledges.

(5) Inspection over intended usage. The causes that lead enterprises to apply for guarantee should be inspected. If it's because of increasing orders or lack of circulating capitals, then the purposes should be verified through investigations into sales contracts, production capacities and other aspects. If the shortage of funds is due to postponed recall of receivables or excess inventories, then inventory changes and remaining collection days should be followed to ensure the authenticity of intended usage.

4. Financial analysis in guarantee qualification inspection

(1) Analysis of debt-paying abilities. Debt-paying abilities can be categorized as short-term debt-paying ability and long-term debt-paying ability, of which the former can be implicated through three indicators, namely current ratio, quick ratio and currency ratio, the higher these ratios are, the stronger the short-term ability is. However, they should fall in a reasonable range, if too high, it means the inspected enterprises have low asset activity ratios. Long-term debt-paying ability is basically represented by debt-asset ration and interest protection multiples.

(2) Analysis of operation capability. Accounts receivable turnover and inventory turnover are two major indicators of operation capability. Generally speaking, a fast receivable turnover means strong ability to recover money, and a quick inventory turnover means the inventories are much welcomed and can be easily realized into available cash or accounts receivables, and it means the capital of inspected enterprises are not over occupied by inventories. Both the indicator should be compared to industry average figures to estimate operation capability.

(3) Analysis of profitability. Gross income ratio, net profit ratio and operation cash income ratio are three most significant indicators representing profitability. Gross income ratio reflects financially enterprises' core competitiveness, and is positively relevant to enterprises' ability to cover period expenses. Net profit ratio is the ultimate manifestation of profitability. Only if the products are highly profitable and management is quality can net profit margin reaches a high point.

Operation income cash ratio represent the net cash flow in operational activities per sales income. It reveals the proportion of cash income in operation revenue during the current period, and reflects the quality of profits.

5. Financial analysis in management during the period when guarantee in in force

(1) Keep close watch on loan funds flows. The usage of loans should be tracked to ascertain proper utilization according to contracted purposes and without embezzlement. Relevant reviews can be accomplished by checking bank statements, purchase-and-sale contracts and purchase-and-sale invoices; and by comparing material purchase subsidiary ledgers, instore tables and materials in storage. Should embezzlement be detected, enterprises would be warned immediately to correct its behavior, of which those refuse corrections should be removed from guarantee to eliminate risks for guarantee agencies' sake.

(2) Observe funds management state. Regular inspections into funds-in and funds-out are necessary to ensure loan funds are not transferred into personal accounts. Significant attention should be paid to recovered sales income, and careful analysis of accounts receivables changes should be conducted to see if any sales income was transferred to personal accounts. It's always the case for enterprises to secretly withdraw funds and escape debts when they are trapped in operation difficulties and funds management is out of control.

(3) Follow the fluctuations in gross profit ratio. Regular analysis of gross profit ratio changes should be conducted to look out for enterprises fabricating losses by adding purchasing costs, reducing prices or colluding with relevant parties in order to transfer funds and escape from liabilities.

6. Conclusion

In a nutshell, to protect financing guarantee agencies from substitutive payment, financial analysis should be applied in three phases, namely before, during, and after guarantee, to identify and control risks. In this intertwined risk management measures, financing guarantee agencies can keep a tight grip of the overall situation and play it safe.

References

- [1] Liang Xian, A Case Study on Financing Guarantee Risk Control of YX, Master Dissertation, Jun 2015
- [2] Zhao Cheng, a Research on Risk Management of Lanya Guarantee Group on the Basis of Financial Statements, Apr 2016
- [3] Zhou Yanlong, Application of Financial Statements Analysis in Credit Business in Bank of Ningxia, Mar 2015
- [4] Zhang Rong, Gao Hua, Prevention of Risk in Financing Guarantee Business from a Financial Perspective, Jun 2017
- [5] Ren Yongping, Mei Qiang. Financial Analysis of Several Important Parameters of SME Credit Guarantee Fund [J]. Quantitative Economic Technical Economic Research, Feb 2002
- [6] Chen Peng. Simple analysis of financial and economic comprehensive analysis and its application [J]. Tax Payment, Nov 2018.
- [7] Li Yonghong. A Probe into the Methods of Strengthening Financial Management of Financing Guarantee Companies [J]. Times Finance, Mar 2018.
- [8] Cao Fengqi. Establish and improve the credit guarantee system for SMEs [J]. Financial Research, May 2001
- [9] Wang Qin. Research on Development Obstacles and Cracking Paths of New-type Guaranteed Financing for Small and Medium-sized Enterprises [J]. Shanghai Finance, Apr 2019
- [10] Wu Qiusheng, Du Zhengyuan. Mixed ownership reform, government implicit guarantees and excessive debt of state-owned enterprises [J]. Economic Management, Aug 2019