

## THE IMPACT OF LIQUIDITY RATIOS IN THE ACTIVITY OF A COMPANY. CASE STUDY

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*Abstract: During the activity of a company events may come up making necessary sums payable larger than the proceeds. Thus, the net treasury has to be positive but one has also to take into account the liquidity ratios which are pretty important and their calculation shows the position of the company as compared to the liquidities it has and those it should have. In our scientific approach we have shown that though the company has working assets, a low value of the availabilities may create problems to its activity.*

*Keywords: liquidity, working assets, short term debts, stocks, availabilities*

### INTRODUCTION

The increase in complexity of the financial activity of a company, under the terms of the passage to the market economy has deep implications in the process of adopting managerial decisions which enforce the abandon of the routine and the use of scientific methods based on knowing the reality, with a view to the establishment of the causal links between the economic phenomena and the financial situation.

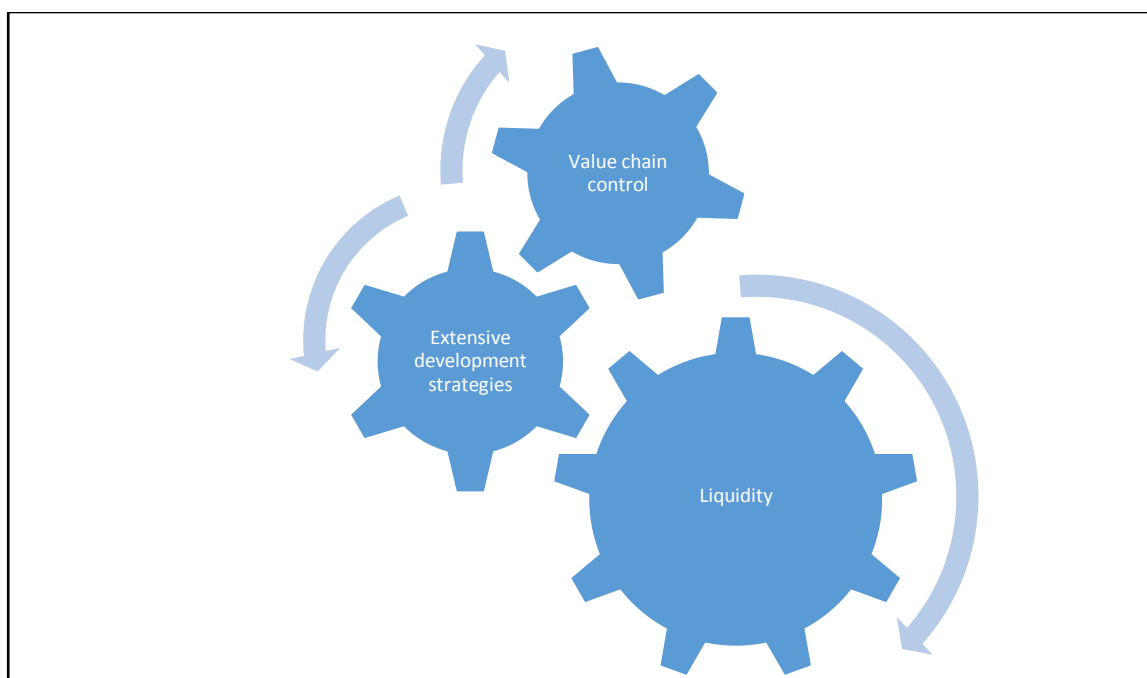
The approach of the problems which regard the financial-accounting problems of a company through the prism of the cause-effect relation imposes the interdisciplinary study of the resources consuming economic and financial activity with direct reflection in its financial performances. (Petrescu, 2006).

### THE ROLE OF LIQUIDITY IN STRATEGIC APPROACHES FOR CONTROLLING THE VALUE CHAIN

Companies that have good liquidity adopt broad-based development strategies through horizontal integration. Under these strategies, firms that have good liquidity can acquire many of the competing firms to strengthen their position on the market by gaining a larger market share. Higher market share will mean higher revenue in the future and a better competitive position than the main competitors. Also from a strategic point of view, firms with high liquidity can resort to extensive development strategies through upstream vertical upgrading or extensive development strategies through vertical upstream integration. Extensive development strategies through vertical upstream integration involve the purchase of suppliers to control the purchase prices of raw materials, materials and other products purchased for their own business.

Extensive development strategies through downstream vertical integration typically involve the acquisition of companies involved in the distribution of products and services. From a strategic point of view, good liquidity provides the prospect of better control over the value chain. This

relationship between liquidity and the competitive position of the firm is more correctly reflected in the following figure.



**Figure no.1 The relationship between liquidity, value chain control and extensive development strategies**

Liquidity is also useful for comparing the competitive capacity profile of the organization with that of the competition environment. In the financial sector, strategic diagnosis includes profitability, liquidity and solvency indicators. Strategic liquidity analysis should include at least the following steps:

- analysis of company liquidity;
- comparison between firm liquidity and liquidity of the strongest competitor;
- comparison of the company's liquidity with the ideal profile of the industry so that the position of the firm can be assessed from the point of view of liquidity compared to the whole of the industry.

The strategic diagnosis of the organization, which includes the economic and financial diagnosis (including the analysis of the liquidity of the organization), is the starting point for the outline of the company's main strategic options, along with the analysis of the external environment. If a firm does not have adequate liquidity, it will be in a strategic disadvantage compared to the main competitors. According to the specialists “there are required concrete measures to enhance the performance of the organizations and one of the solutions is implementing and developing the performance management practices within the companies that operate in this field” ( Gîrneală, Giurgiu, Dobrin, Popa, Popescu et al, 2015).

In Romania though „many new companies that are in a rapid growth” (Popescu, 2013) the issue of liquidity may also arise for these businesses. According to Coface reports, about 80% of Romanian companies that reported higher revenues than previous years actually have liquidity problems. Liquidity problems may lead to insolvency. That is why the Romanian companies are interested in liquidity analyzes, which allow a quicker quantification of the signals regarding the precarious liquidity. Some authors consider that “in order to generate competitiveness on local and international markets, it becomes vital for these types of enterprises to investigate new managerial approaches, methods and capabilities”.(Ceptureanu S.I, Ceptureanu E.G., Simion-Melinte C.P, Borisov D, 2016).

The liquidity precariousness, even if the calculated immediate liquidity records the appropriate values, can have as sources: the transformation of the original liquid receivables into uncertainty receivables or the perishability of the stocks (which may result in the decrease or even the loss of their value). In the case of stocks, seasonality may be a disturbing factor in the accuracy of the liquidity analyzes performed. (Rus, M.I., 2014)

## CASE STUDY RELATED TO LIQUIDITY RATIOS

The information which are the basis of this scientific approach come from the financial statements of the company FEMIR PRODIMPEX SRL.

Liquidity measures the ability of a company to go through short term obligations and reflects the capacity to turn fast the working assets into monetary availabilities. In the specialty literature it is considered that a company is “liquid” when the resources made available from current operations of the exercise supply sufficient availabilities to go through short term maturities. The liquidity of a company amplifies its importance in certain phases of the economic circuit. If, during their good periods, companies generally have a liquidity which comes within normal limits, during recession periods, the company liquidity may be a source of competitive advantage. Under the recession terms which generate liquidity issues for the majority of the companies, the companies having a normal liquidity may capitalize their liquidity by: acquiring assets or competitors undergoing a liquidity crisis. Kim, Mauer and Sherman 1998 underline that: “the optimal amount of liquidity is determined by a trade off between the low return earned on liquid assets and the benefit of minimizing the need for costly external financing”.

The notion of liquidity may regard the balance sheet and its assets each having its own significance: the liquidity of the balance sheet refers to the fact that the assets below 1 year are superior to the debts below 1 year, a thing which shields the company against short term bankruptcy (Petrescu, 2006).

The main liquidity ratios are: the current ratio, acid test ratio and the quick ratio. The manner of calculation for each one of them is the following:

$R_{lg} = \text{working assets} / \text{current liabilities}$

$R_{lr} = (\text{working assets} - \text{stocks}) / \text{short-term debts}$

$R_{li} = \text{availabilities} / \text{short-term debts}$

Data on the calculation of the three ratios for the period between 2012-2015 are shown by table 1:

**Table 1.** Indicators for the calculation of the liquidity ratios for the period between 2012-2015

(lei)

No.	Indicators	2012	2013	2014	2015
1.	Working assets	267.445	280.482	282.355	328.820
2.	Short-term debts	139.888	146.606	125.849	159.694
3.	Stocks	188.252	217.433	206.565	221.984
4.	Availabilities	761	7.216	5.661	3.516

(The author’s processing according to the financial statements of [2])

The data shown by Table 1 result in some conclusions:

- The working assets followed an ascending trend so that in 2013 we have a value greater by 4,9% than in 2012, in 2014 a value which was greater by 5,6% than in 2012 and by 22,94% greater than in 2015 as compared to 2012;
- Short term debts had a fluctuating evolution: thus, if in 2013 they had a value which was greater by 4,8% as compared to 2012, in 2014 their value represented 89,96% of the value of 2012, and in 2015 the value was greater by 14,16% as compared to 2012;
- Stocks had an evolution almost similar to that of the working assets: in 2013 the value of the stocks was greater by 15,50% than that of 2012, in 2014 the value of the stocks was greater by 9,73% as compared to 2012, and the value of 2015 was greater than that of 2012 by 17,92%;
- The availabilities had an identical evolution with stocks: in 2013 their value was greater by 948.23 % than in 2012, in 2014 greater by 743,89% than in 2012, and the value of 2015 was greater by 462,02% than in 2012.

Using the data of Table 1 and the calculation formulas for the three ratios we get the following values:

**Year 2012**

$$Rlg = 1,91$$

$$Rlr = 0,57$$

$$Rli = 0,01$$

**Year 2013**

$$Rlg = 1,91$$

$$Rlr = 0,43$$

$$Rli = 0,05$$

**Year 2014**

$$Rlg = 2,24$$

$$Rlr = 0,60$$

$$Rli = 0,04$$

**Year 2015**

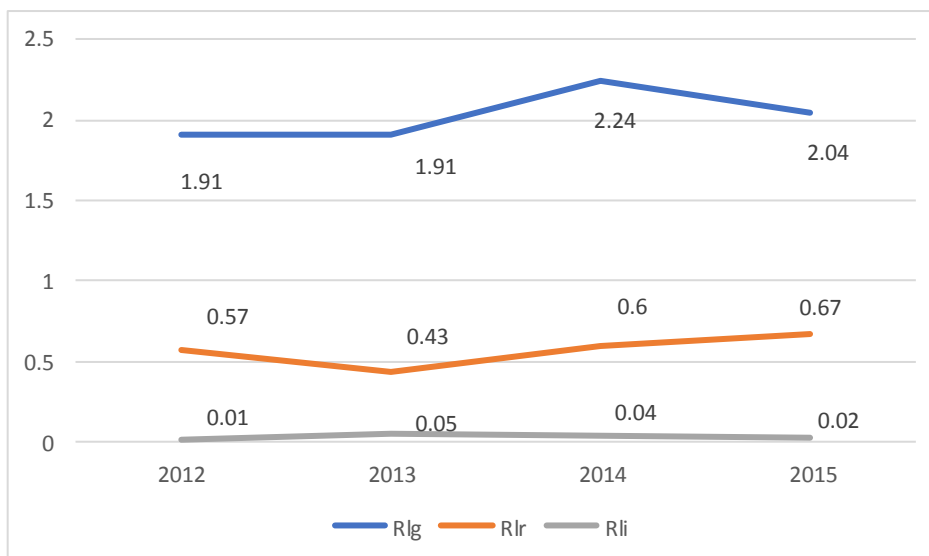
$$Rlg = 2,06$$

$$Rlr = 0,67$$

$$Rli = 0,02$$

Graphically, the results obtained are shown by chart 1.

**Chart 1. FEMIR PRODIMPEX SRL Liquidity ratios for the period 2012-2015**



(The author's processing according to the financial statements)

Analyzing the data shown by Chart 1, we may ascertain as follows:

- The current ratio comes within normal limits, i.e. it is improper and even greater than 2, due to the fact that, besides the stocks, the company has other working assets also;
- With one exception, that of the value of 2013, the acid test ratio also comes within normal limits, i.e. higher than 0.5 and depends a lot on the value of the stocks. Thus, if in 2013 we had an increase of the working assets of 4,8% and of the debts of 4,9%, in exchange, the value of the stocks increased by over 15% (15,50%), which determined that the value of the acid test ratio be lower than 0,5;
- The quick ratio is lower than the minimum limit of 0.235, which means that the respective company must rethink the situation of the net treasury as it may reach a situation in which it will not be capable of paying certain invoices to certain suppliers which have products with great merchantability.

## CONCLUSIONS

For the good running of its activity and from the point of view of the liquidities, FEMIR PRODIMPEX SRL must rethink its strategy for the future and take into account certain aspects such as: the goods supply must consider the briefest possible stocking period as well as an increase of the working assets also from the side of the availabilities in order not to reach the situation in which it will not be capable of making payments having to resort to credits which, implicitly, will increase the company liabilities.

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