# АКТУАЛЬНІ ПИТАННЯ ЕКОНОМІКИ ТА УПРАВЛІННЯ
## У СУЧАСНИХ СОЦІАЛЬНО-ЕКОНОМІЧНИХ УМОВАХ

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**міжнародної**
**науково-практичної**
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# CYCLE OF WORKING CAPITAL AND LIQUIDITY - ADDITIONAL ANALYZES

Conceptual framework relating to liquidity is determined by two concepts. *The first* outlines the operative liquidity [1, p.190] and is generally associated with “the availability of cash in the near future, after taking account of financial commitments over this period” [2, p.45]. This direction is indicated by G. Hawawini and C. Viallet, that if a company can not pay its creditors - bankers and suppliers – it is de facto bankrupt [3, p.67].

There are opinions (R. Ivanova and L. Todorov) that connect the liquidity of a company's ability to meet its current obligations with cash and other *quick-liquidity assets (my italics - PP)*[4, p.545]. It should be noted that, at first glance, this statement incorporates the restrictive condition of “quick-liquidity”. However, it emphasizes that whether a company will be able to cover its current liabilities depends exactly on the degree of rapidity of the transformation of an asset into cash. It could be argued that this opinion is intermediate between the concept which compares current assets to current liabilities and that which links liquidity to holding cash and other liquid assets convertible into cash, ie with the working capital cycle.

As stated above, the *second concept* which characterizes liquidity is associated with the working capital cycle. A number of authors (Hermanson, Edwards and Salmanson [5, p.779], Bernstayn [6, p.397], Helfert [7, p.157], Bocharov [8, p.89]) specify that liquidity is related to the possession of money and other assets that will be converted into cash. N. Kostova indicates [1, p.190] that liquidity (expressed by the ability to convert assets into cash) is known as absolute or structural.

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Could the financial and economic crisis be a factor, forcing companies to invest only in their most necessary (and most marketable) inventories, and to incur additional financial costs associated with minimizing their claims? Does the economic and financial crisis alter the prevailing perceptions of the degree of liquidity of receivables and inventories? Is the analytical information that comes from Quick ratio of sufficient quality in a crisis situation?

To answer these and other related questions, the following lines will present a summary of the results of an extensive market research in the sector of Automobile sales in Bulgaria.

In any research process is most difficult to determine the target group, the outcomes of which can be trusted - both in terms of the tasks, and with regard to analytical conclusions. It is a fact that over the last decade the criticism of the financial statements as reliable sources of information that provide insight into the financial position of a company is growing. Reasonable arguments are put forward for the incompleteness of the information contained in the financial statements, arguments about the influence of different user groups in the preparation of the financial reporting framework; arguments concerning the application of the estimates, as well as many other existing objective factors leading to uncertainties and subjectivism [1, p. 21] in the financial reporting.

Given the described limitations pertaining to the subject of the study we can say that one of the potential sectors for analyzing is the primary (official) car market in Bulgaria. Complying with these requirements and limitations in the study analyzed the financial statements of 21 companies from the automotive industry, of which 20 (of 36) members of the Association of car manufacturers and their authorized representatives in Bulgaria (http://www.svab.bg). As part of the research process the financial statements of the companies included in the study were analyzed. Given the number of companies analyzed, and time span - from 2007 to 2010, it can be argued that the study is one of the most comprehensive for the industry.

Changes in working capital of companies surveyed are presented in Table 1. It is clear from the data in this table, in the analyzed period 2007-2010 years there have been significant changes - both in the structure of current assets and the net working capital. An upward trend can be observed both in the current and the quick ratio. It should be noted that the values of these two indicators are the highest in 2010 - the year with the lowest reported profits and sales. At the same time, namely in the period 2009-2010 the trends for increasing the share of claims and for reduction of inventories are the most pronounced. Against this background, the reasonable question is: “Can we rely on conventional analytical tools (those used in a non-crisis situation)?”. It is evident that the increased proportion of claims shows that they are less liquid assets in times of crisis.

Table 1

Working capital and liquidity

*BGN in thousands, unless otherwise stated*

| **Indication year** | **2010** | **2009** | **2008** | **2007** |
|---|---|---|---|---|
| Material inventories | 152 594 | 187 137 | 393 350 | 291 122 |
| *(as a percentage of current assets)* | *(29%)* | *(33%)* | *(49%)* | *(47%)* |
| Trade and other receivables | 274 990 | 329 426 | 343 071 | 264 922 |
| *(as a percentage of current assets)* | *(52%)* | *(58%)* | *(43%)* | *(43%)* |
| Current assets | 526 401 | 570 812 | 801 200 | 617 255 |
| Current liabilities | 351 848 | 433 663 | 596 904 | 472 479 |
| Net working capital | 174 553 | 137 149 | 204 296 | 144 776 |
| Current ratio | 1,50 | 1,32 | 1,34 | 1,31 |
| Quick ratio | 1,06 | 0,88 | 0,68 | 0,69 |
| **Crisis Liquidity Ratio (CLR)** | **0,71** | **0,56** | **0,77** | **0,75** |

In view of the results of the study summarized above, and considering the theoretical aspects related to the underlying economic category “liquidity”, we can say that in a situation of crisis it is much more reasonable and analytically justifiable to use the crisis liquidity ratio (CLR). It is calculated by the formula:

$$\text{CLR} = \frac{(\text{Current Assets} - \text{Accounts Receivable})}{\text{Current Liabilities}} \qquad (1)$$

The economic interpretation of this indicator points toward the real opportunity of an enterprise in a crisis to cover its current liabilities with available liquid assets. In our survey was established a direct correlation between decreasing values of the crisis liquidity ratio and the reduction of sales revenue, and reported profits. I.e. a low ratio may indicate an imminent decline in revenues and profits.

Traditional research tools relating to liquidity rely on the fact that inventories may be difficult to turn into cash. Basically, it is a fact, especially in times of dynamics, and in sectors where the intensity of demand is decisive. However, practice shows that in times of crisis managers prefer to buy only what would sell well. In the absence of free cash and faced with a drop in sales and profits, businesses prefer to direct cash flows to truly liquid assets rather than to additional spending to collect receivables that traditionally have been perceived as „liquid”. In a crisis environment collecting receivables requires the use of additional resources.

Given the change in the structure of working capital in times of crisis it is a must to take into account the real possibility to meet current obligations. In this respect, the crisis liquidity ratio is particularly useful for the management.

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