FINANCIAL TRAINING PARTNERS

# LIQUIDITY

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**Liquidity** is the ability to meet expected and unexpected cash needs with internal and external resources. **Expected needs** are operating outlays, debt service, dividends, capital expenditures, and the like. **Unexpected needs** are legal judgments, business disruptions, product liability claims, and the like. **Internal sources** include cash generated by operations and from the sale of assets. **External sources** include debt and equity.

## KEY MEASURES

| Measure | Formula | Meaning | Use |
|---|---|---|---|
| **Current Ratio** | Current assets ÷ Current liabilities | The amount of current assets available to meet current obligations | Increases caused by lower accounts receivable turnover or inventory turnover may mean declining liquidity |
| **Quick Ratio** | (Cash + accounts receivable) ÷ Current liabilities | The amount of cash and near-cash current assets available to meet current obligations | Use when inventory is slow moving or contains a high proportion of unfinished goods. Increases caused by lower accounts receivable turnover may mean declining liquidity |
| **Liquidity Position** | Surplus cash + Liquid marketable securities + Unused committed borrowing capacity – Short-term debt – Current portion of long-term debt | Sources of immediately available internal and external funds, net of the most critical expected need for funds; funds available for other expected and unexpected needs | Use to monitor the trend in a company's liquidity |

## SOURCES AND USES OF LIQUIDITY

| | Sources | Uses |
|---|---|---|
| **Internal** | • Cash<br>• Cash equivalents<br>• Liquid marketable securities<br>• Funds from operations<br>• Sale of assets | • Operations<br>• Working capital<br>• Capital spending<br>• Disasters, regulatory actions, product recalls |
| **External** | • Committed lines of credit<br>• Uncommitted lines of credit<br>• Commercial paper<br>• Bonds<br>• Equity | • Dividends<br>• Debt service<br>• Share repurchases<br>• Lawsuits, guaranties, margin calls |