AN ANALYTICAL STUDY OF SOLVENCY RATIOS AND ITS IMPACT ON FINANCIAL STABILITY

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ABSTRACT

Management frequently fails to monitor cash or completely ignores it. Effective cash management is essential in any company organization, profit or non-profit. Cash comprises of unrestricted and limited cash accounts, checking and savings accounts, and certificates of deposit. In this study, an analytical research technique was used to examine past data for informed future decision-making. Secondary data, sourced from DLS Traders' annual reports for the period 2019-2023, was utilized to investigate the company's performance and gain insights into its existing operations using ratio analysis like current ratio, cash position ratio, liquid ratio and fixed asset ratio. This investigation revealed numerous key findings that can help enhance operational efficiency, assure liquidity, and increase profitability. In accordance to the analysis, the organization can improve its financial effectiveness through improving receivables collection and optimizing liability payment schedule.

Keywords: Financial Stability, Ratios, Solvency, Performance, Cash Management

I. INTRODUCTION

Cash is likely the most susceptible asset in any firm. Cash is readily stolen, misplaced, mishandled, uncollected, and mismanaged, and it frequently lacks suitable written policies and processes. Management frequently fails to monitor cash or completely ignores it. Effective cash management is essential in any company organization, profit or non-profit. Cash comprises of unrestricted and limited cash accounts, checking and savings accounts, and certificates of deposit. Cash equivalents include treasury bills, money market funds, commercial funds, and federal funds. All cash and cash equivalents must be shown as current assets in the financial records in conformity with (generally accepted accounting principles). Cash management is the collecting, handling, utilization, and (short-term) investment of cash.

In other terms, it is the management of a company's cash inflow and outflow.

Cash management encompasses a wide range of financial activities. It also entails evaluating investments. There is more to successful financial management than just avoiding insolvency. It also entails adjusting the time of accounts receivable and payable to ensure a positive working capital cycle. This technique not only protects from insolvency but also improves the overall financial condition and agility of the company. undoubtedly the most critical duty for business managers. Insolvency occurs when a company is unable to pay its bills on time owing to a lack of funds. In fact, unemployment is the primary cause of bankruptcy. Effective handling of cash is critical to maintaining the existence of a new business. It is also important for a growing firm. Cash flow can be a difficulty for a small firm with a large number of customers; even organizations selling the best goods on the market might experience.

A company with cash flow problems is at the mercy of the elements. Put simply; it has no margin of safety. When expenses appear that it had not expected, it is in trouble. A cash flow statement provides information about the changes in cash and cash equivalents of a business by classifying cash flows into operating, investing and financing activities. It is a key report to be prepared for each accounting period for which financial statements are presented by an expertise. Monitoring the cash situation of any business is the key. The income statement would reflect the profits but does not give any indication of the cash components. The important information of what the business has been doing with the cash is provided by the cash flow statement. Like the other financial statements, the cash flow statement is also usually drawn up annually but can be drawn up more often. It is noteworthy that cash flow statement covers the flows of cash over a period of time (unlike the balance sheet that provides a snapshot of the business at a particular date). Also, the cash flow statement can be drawn up in a budget form and later compared. The receipts and payments for trading activities are popularly known as operational cash flows. The allocation of responsibilities of the cash flows varies from organization to organizations depending upon the size, structure of the management, geographical location of the organization and also the relationship between the organization and its customers and suppliers. Raising funds through issue of share capital, long-term loans, capital gearing, acquisitions and major capital expenditures, also controlled by the head office.

1.1 NEED OF THE STUDY

Studying cash management using ratio analysis is critical for a company's financial health and stability. It offers critical tools for managing liquidity, increasing operational efficiency, making sound decisions, and guaranteeing compliance. This study will involve gathering financial data, calculating key financial ratios, and evaluating DLS Traders' positions in order to provide actionable insights and suggestions.

1.2 SCOPE OF THE STUDY

The scope of Cash management includes the collection, handling, and use of cash, as well as assuring liquidity, maximizing the use of financial resources, and maintaining a cash inflow/outflow balance. It includes tasks including financial forecasting, budgeting, allocating idle funds, and overseeing short-term finance.

a) It contributes to the development of a well-defined controlling and collection system for effective cash management.
b) It is helpful to understand the company's ability to satisfy short-term liabilities without depending on inventory sales.

1.3 LIMITATIONS OF THE STUDY

1. The study is restricted to a minimum of five financial years.
2. A potential limitation of this study is that it relies primarily on ratio analysis for assessing cash management.
3. The study is confined to a short period of 8 weeks.
4. The study mainly depends on the secondary data taken from annual report and internal records of the company.

1.4 OBJECTIVES OF THE STUDY

1. To examine the financial position of the company.
2. To analyse the operational efficiency of the company.
3. To measure the financial stability of the company.
4. To measure profitability of the company.

II. REVIEW OF LITERATURE

S. Satheesh Kumar (2024), the project titled “A Study on cash management” for deals with the movement of money into or out of a business, project, or financial product. It is usually measured during a specified, finite period of time. The need for Cash to run the day- to-day business activities cannot be over emphasized. One can hardly find a business firm, which does not require any amount of Cash. Indeed, firms differ in their requirements of the Cash. A firm should aim at maximizing the wealth of its shareholders. In its endeavour to do so, a firm should earn sufficient return from its operation. Earning a steady amount of profit requires successful sales activity. The firm has to invest enough funds in current asset for generating sales. Current asset are needed because sales do not convert into cash instantaneously. There is always an operating cycle involved in the conversion of sales into cash. The objectives are to analyse the Cash management and to determine efficiency in cash, inventories, debtors and creditors.

Yan, Chen and Ding (2020), in this study the decision to adopt payables finance is influenced by several factors, including cash flow uncertainty, risk aversion, and the overall financial health of the supplier. They explore the supplier's optimal cash policy under a payables finance arrangement. The authors argue that the supplier's future cash flow uncertainty and risk aversion are key drivers of the cash liquidity value provided by payables finance. Suppliers facing high levels of cash flow uncertainty or those with a risk-averse financial strategy are more likely to derive significant value from adopting payables finance.

Brigham and Houston (2019), a study on the objectives of cash management have significantly evolved over time. The early cash management practices primarily focused on ensuring that businesses had enough liquidity to meet their immediate financial obligations. This approach was largely reactive, with firms maintaining substantial cash reserves to safeguard against unforeseen financial needs. However, as businesses grew and financial environments became more complex, the emphasis shifted towards optimizing cash balances to achieve a balance between liquidity and profitability

Brigham and Houston (2019), cash management encompasses a wide range of financial activities aimed at optimizing the use of cash within an organization. Cash management involves the efficient collection, handling, and deployment of cash to maximize an organization's financial stability and operational efficiency. The primary objective is to ensure that the company has enough liquidity to meet its obligations while investing any surplus cash to generate additional returns.

Kumar and Sharma (2019), despite the advancements in cash managementpractices, sugar factories face several challenges in maintaining optimal cash flow. Fluctuating market prices, changes in government policies, and the seasonal nature of sugar production all contribute to cash flow uncertainty. These challenges necessitate a more dynamic approach to cash management, where factories must continuously adapt their strategies to maintain financial stability.

Jebran et al. (2019), examine the impact of the 2008-2009 financial crisis on the cash holdings of Chinese companies between 1999-and 2009. During a financial crisis, cash holdings rise, demonstrating a positive correlation between cash holdings and financial turmoil. Cash holdings are positively affected by growth prospects, cash flow, dividends, and cash flow volatility, whereas cash holdings are negatively affected by the size, leverage, and networking capital.

Mohan and Shanmugam (2018), a study on cash management in the sugar industry, like many other manufacturing sectors, relies heavily on efficient cash management to maintain operational stability and profitability. The cyclic nature of sugar production, which is influenced by seasonal factors and market volatility, makes cash management particularly crucial for sugar factories. These factories must carefully manage their cash flows to ensure they have enough liquidity during off-peak seasons while also optimizing cash use during peak production periods.

Deloitte (2017), the integration of digital technologies in cash management processes has significantly enhanced the efficiency and accuracy of cash management activities. Digital tools such as cash management software, electronic invoicing, and automated reconciliation systems have streamlined cash management workflows and reduced the likelihood of errors. According to a report by, digitalization in cash management has enabled companies to improve their cash forecasting, optimize working capital, and enhance financial decision-making.

Lydiah Wambui Ndirangu (2017), in this study, researcher analyze the effect of cash management on the financial performance of the companies listed at The Nairobi Securities Exchange, for which 15 Companies were selected and descriptive research design was used. The study based on secondary data collected for 7 years (2010-2016) from NSE, published financial statements from respective websites of company and capital market authority. Researcher analyzed the data with the help of multiple regression and correlation. Study found positive but insignificant effect of cash conversion cycle on financial performance, negative and insignificant effect of size of company on financial performance and positive and significant effect of leverage on financial performance of selectedcompanies. Therefore, it was recommended by researcher to increase the debt proportion in its capital structure which improves the financial performance of selected samples.

III. RESEARCH METHODOLOGY

Research is a systematic process aimed at discovering new information, understanding phenomena, and solving problems by collecting, analysing, and interpreting data. The research design serves as the blueprint for conducting the study, ensuring that data is collected and analysed effectively. In this study, an analytical research technique was used to examine past data for informed future decision-making. Secondary data, sourced from DLS Traders' annual reports for the period 2019-2023, was utilized to investigate the company's performance and gain insights into its existing operations.

IV. ANALYSIS AND INTERPRETATION

4.1 Current Ratio

The Current Ratio is a financial metric that assesses a company's capacity to satisfy short-term obligations using short-term assets. It is determined by dividing current assets with current liabilities.

$$\textit{Current Ratio} = \frac{\textit{Current Asset}}{\textit{Current Liabilities}}$$

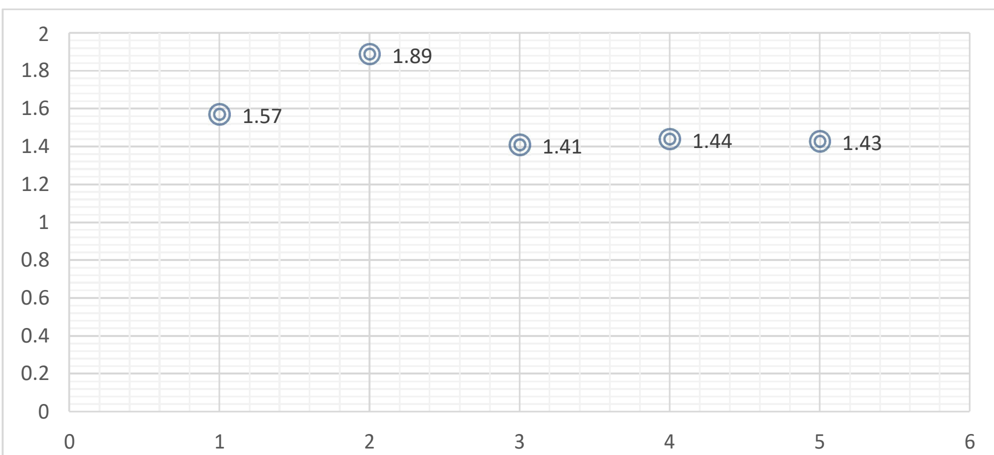

Figure 4.1: Distribution of Current Ratio

4.2 Cash Position Ratio

The Cash Position Ratio is a liquidity ratio that measures a company's ability to cover its short-term liabilities using only its most liquid assets, cash and cash equivalents (like bank balances or marketable securities). It provides insight into the company's immediate financial strength and its capacity to meet urgent obligations without relying on less liquid assets like inventory or receivables.

$$\text{Cash Position Ratio} = \frac{\text{Cash \& Bank Balance + Marketable Securities}}{\text{Current Liabilities}}$$

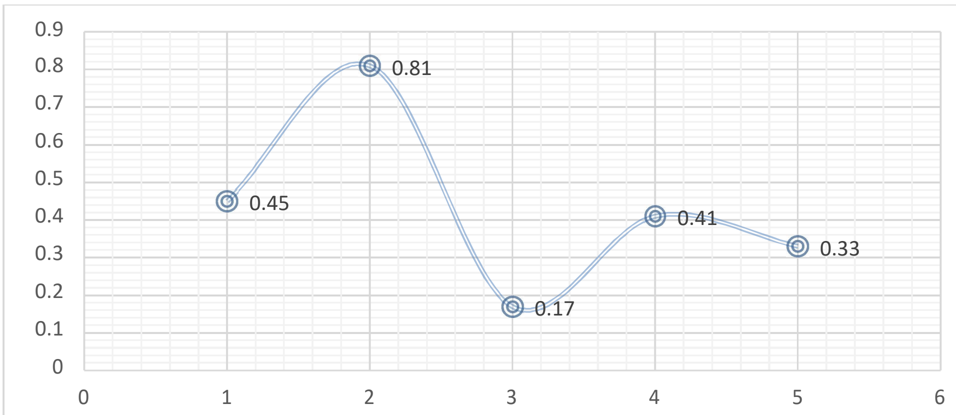

Figure 4.2: Distribution of Cash Position Ratio

4.3 Liquid Ratio

The Liquid Ratio, also known as the Quick Ratio or Acid-Test Ratio, measures a company's ability to meet its short-term liabilities using its most liquid assets, excluding inventory. This ratio provides insight into a company's immediate liquidity position and its ability to pay off current obligations without relying on the sale of inventory, which may not be quickly convertible to cash.

$$\text{Liquid ratio} = \frac{\text{Liquid Asset}}{\text{Current Liability}}$$

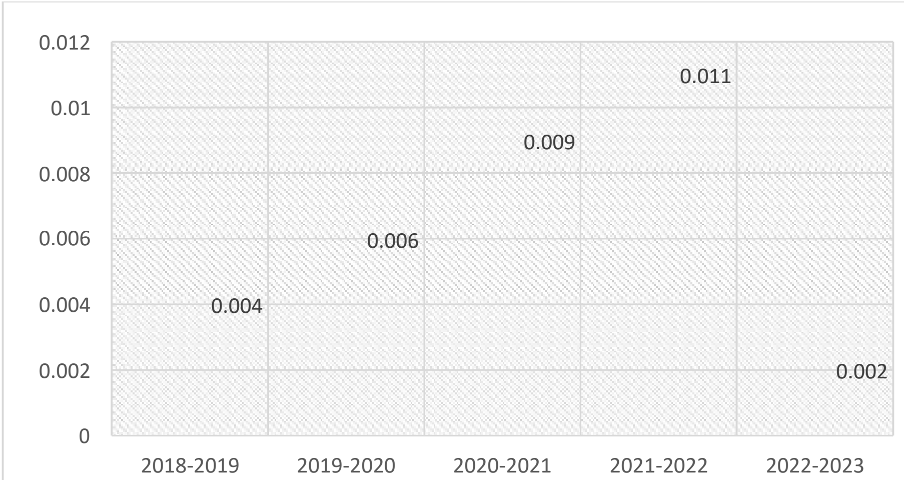

Figure 4.3: Distribution of Liquid Ratio

4.4 Fixed Asset Ratio

The Fixed Asset Ratio is a financial metric used to measure a company's ability to use its fixed assets to generate revenue. It compares the company's fixed assets to its total long-term capital (including equity and long-term liabilities).

$$\textit{Fixed Asset Ratio} = \frac{\textit{Net Fixed Assets}}{\textit{Long-term Capital}}$$

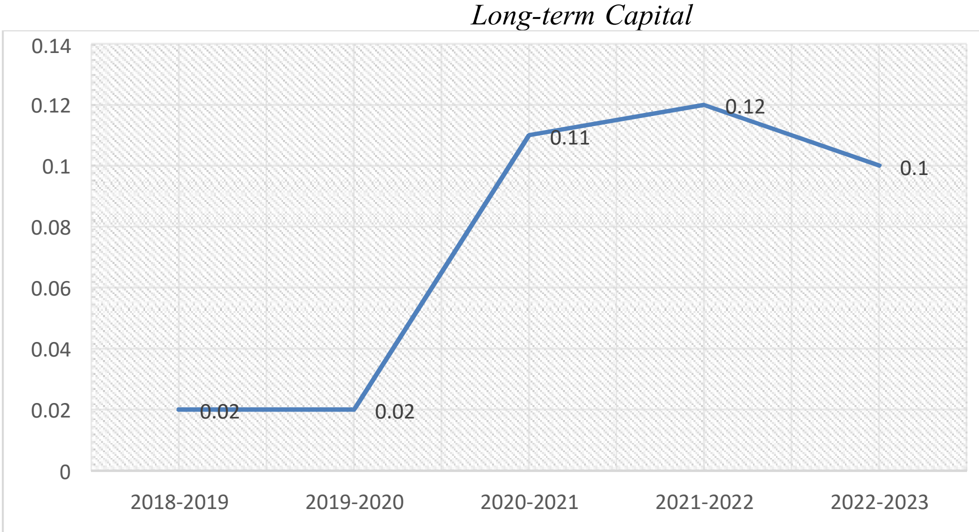

Figure 4.4: Distribution of Fixed Asset Ratio

V. FINDINGS

1. The standards norms for the current ratio are 2:1. In the company current ratio in the year 2019-2020 is high 1.89 but in the year 2022-2023 is decreased 1.43 is not efficient manner. So, the short-term solvency position of the company is not good position.
2. Cash Position Ratio in 2018-2019 is decreased 0.45, 2019-2020 is increased 0.81, 2020-2021 is much decreased 0.17. Since the cash position ratio shows that the organization's financial position is at the moderate stage. The result that I got is the type of oscillating manner which implies that the company should more concentrate on its cash position.
3. The standard norms for the Liquid ratio are 1:1. The company limited liquid ratio is below standard norms. So, the financial soundness of company in the year 2021-2022 is 0.011 satisfactory positions. But 2022-2023 is 0.002 is not effective one.
4. In the year 2021-2022 is 0.12 is increased and 2022-2023 is 0.10 is decreased. The company can try to utilize the fixed assets in efficient manner. It will create a higher productivity and also create profit.

VI. SUGGESTIONS

1. The current assets should be managed more effectively so as to avoid unnecessary blocking of capital that could be used for other purposes.
2. The decrease in the cash position ratio suggests that the company's financial position is moderate but unstable. This indicates a need for the company to focus more on improving its cash management.
3. The company can try to utilize the fixed assets in efficient manner. It will create a higher productivity and also create profit.

VII. CONCLUSION

In conclusion, efficient financial management is critical to the company's overall health and sustainability. This investigation revealed numerous key findings that can help enhance operational efficiency, assure liquidity, and increase profitability. In accordance to the analysis, the organization can improve its financial effectiveness through improving receivables collection and optimizing liability payment schedule. Through narrowing the gap among incoming and exiting cash, the company can improve everyday operations, maintain a healthy financial position, and promote long-term growth.

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