Erasmus+

Creativity + Innovation & Technology

LESSON CONTENT TEMPLATE

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## 1. Lesson Document

Topic 6: Financial Ratios
Lesson 3

**Liquidity and leverage ratios**

**Introduction**

Financial indicators are created by using numerical values taken from the financial statements in order to obtain significant information about the company. We have already talked about productivity and efficiency, and now it's time to learn what are liquidity and leverage ratios and which formulas accompany them.

Resource: Pixabay

**Liquidity ratios**

Ratios used to determine a debtor's ability to repay current debt obligations without raising external capital. (*Liquidity Ratio Definition*, 2021).

**Current ratio** - It measures whether current bills can be paid. . (*Finance and Business Strategies for the Serious Entrepreneur*, 2008)

**Current ratio = Current assets/Curent liabilities**

**Quick ratio** - It measures liquidity. It recognizes that some working capital, especially inventories and prepaid expenses, cannot be easily converted into cash if the company is facing difficult times. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008).

**Quick ratio = Current assets - inventory and other illiquid assets)/current liabilities**



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**Cash ratio** - Includes cash on hand, the cash balance in bank accounts, and Short-term Investments.

**Cash ratio = (Cash + Short-terms Investments)/Current Liabilities**

**Leverage ratios** It evaluates a company's capital structure and long-term potential solvency. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008).

**Debt/Equity ratio** - It measures the degree to which the company has leveraged itself. (*Finance and Business Strategies for the Serious Entrepreneur*, 2008).

**Debt/Equity ratio = Total liabilities/ Stockholders equity**

**Conclusions**

Ratios are an important assessment tool that business owners and managers can use to quickly assess an organization's performance. The information revealed through these indicators and the ability to assess changes in these relationships provide an opportunity to make the necessary changes to improve the vitality of the company.



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