LIQUIDITY OF THE SECTOR OF ENTERPRISES IN THE PERIOD OF ECONOMIC RECESSION IN POLAND

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Abstract: *This article aims to highlight the impact of the economic recession in the economy at the enterprises' liquidity and strategy of its management. It is suggested that liquidity needs increase for firms when the economy is in poor economic conditions or is in recession. This article focuses on the analysis of the changes in liquidity level and based on financial statistic data of companies in Poland. Liquidity is a complex concept defined by multiple factors, which are used by different ways. Most managers recognize that liquidity is a vital and constant factor in maintaining financial stability, regardless of condition of the economy. However economic situation of the country is one of the most important factor determining financial liquidity of the company. Turbulent economic conditions of recent years, mostly unfavorable, means that* maintaining financial liquidity is a priority task of every entrepreneur. *Liquidity analysis is the process of measuring a company's ability to meet its maturing obligations. Sometimes, a company having difficulty paying off its current obligations is unlikely to be able to convert its accounts receivable or inventory quickly into cash without substantial loss of value. Liquidity measurements are designed to provide information about the paying ability and financial flexibility of the firms. The most basic liquidity ratios are current ratio and quick ratio. Their high levels indicate a firm with a good liquidity position. If they are too high the company will be overliquid, but if they are too low it can create problems with current functioning.*

Keywords: *financial liquidity, enterprises, economic crises, recession*

JEL Classification: *G31, G39*

1. INTRODUCTION

The most important current problem of every economic entity is maintaining financial liquidity, i.e. capability of meeting current liabilities. Losing liquidity is one of the main factors leading to an enterprise's bankruptcy. Inability to settle payments in a timely manner damages the company's reputation very quickly and as a result it cannot obtain funds from a bank or even a merchant credit (Sierpińska, Wędzki 1997). This highlights the role of effective management of liquidity and constant analysis of cash flows of an enterprise, which may allow it to experience a stable growth also in the long run.

Intensity of changes occurring in the environment of modern enterprises may represent a threat for firms that function according to the patterns developed over the last decades, but at the same time it creates chances for those entities that are actively looking for a place for themselves in the new reality. In this context, we can see a growing importance of an enterprise's strategy as an instrument which makes it easier for an enterprise to function in changing conditions. Looking from the perspective of the main goal of enterprises – maximization of the value for the owners – it must be said that financial aspects are playing an increasingly important role in designing, implementing and assessing strategies of an enterprise. Thus, an integral part of the overall strategy of an enterprise should be financial strategies, formulated in different areas of financial management, including liquidity management.

Effective management must be based on a solid knowledge which comprises, among other things, factors determining the current state and future development. A range of external and internal factors should be taken into account when managing financial liquidity. One of the external determinants referring to general financial liquidity of an enterprise is certainly the economic situation. The aim of this paper is thus to determine the impact of the economic situation, in particular the crisis that followed after 2008, on the level of liquidity in the Polish business sector and changes in the strategy for liquidity management.

2. LIQUIDITY OF THE ENTERPRISES AND THE FORMS OF ITS MEASUREMENT

Liquidity is a complex concept defined by multiple factors, which are used by different ways. Most managers recognize that liquidity is a vital and constant factor in maintaining financial stability, regardless of condition of the economy (Nelson 1977). However economic situation of the country is one of the most important factor determining financial liquidity of the company. During economic recession, *maintaining financial liquidity is a priority task of every entrepreneur.*

Liquidity analysis is the process of measuring a company's ability to meet its maturing obligations. Sometimes, a company having difficulty paying off its current obligations is unlikely to be able to convert its accounts receivable or inventory quickly into cash without substantial loss of value (Tarnóczi, Fenyves 2011). Liquidity measurements are designed to provide information about the paying ability and financial flexibility of the firms. The most basic liquidity ratios are current ratio and quick ratio. Their high levels indicate a firm with a good liquidity position. If they are too high the company will be overliquid, but if they are too low it can create problems with current functioning.

The current ratio is frequently used to determine if a firm can meet its short-term obligations. If a firm is to survive and prosper, funds must be readily available for current operations. Recession and unfavorable economic condition increase the need for a comfortable margin to meet maturing obligations, as losses may come from liquidating securities, receivables and inventories (Fleming 1986). The current ratio is a simple calculation: current assets divided by current liabilities. Traditionally, a current ratio of 2:1 or higher was regarded as appropriate for most businesses to maintain creditworthiness. However, more recently a figure of 1.5:1 is regarded as normal (Tóth, Čierna 2013). Because inventories can drag down the current ratio, the quick ratio (also known as the "acid-test ratio") is sometimes advanced as a better presentation of a firm's ability to meet obligations. The quick ratio is the current assets minus inventories divided by current liabilities (Skomp, Edwards 1978). Generally, the acid test ratio should be 1:1 or higher, however this varies widely by industry.

The analyzes in the article are based on financial statistic data of companies in last 2 decades in Poland and were provided by institutions such as OECD, National Bank of Poland or *Central Statistical Office in Poland.*

3. CHANGES IN FINANCIAL LIQUIDITY OF ENTERPRISES IN A CHANGEABLE ECONOMIC SITUATION

One of the main indicators of a country's macroeconomic situation is GDP (Gross Domestic Product). Annual changes in GDP allow us to compare the economic situation of a particular country with other countries in the region or the world. As Fig. 1 shows, the period of economic downturn in Poland was between 2000 and 2002 and, like in the entire European Union, after 2008, when we saw a clear deterioration in macroeconomic indicators as a result of the financial crisis which had originated in the USA. However, while in most EU countries the annual changes in GDP displayed negative values, in Poland GDP still grew, with the lowest value in that period being +1.6% in 2009. Thus, it is more appropriate to say that Poland experienced economic downturn rather than a real crisis. However, given that over the last two decades GDP increases in Poland were at significantly higher levels than the EU average, such GDP growth, though positive, is not satisfactory.

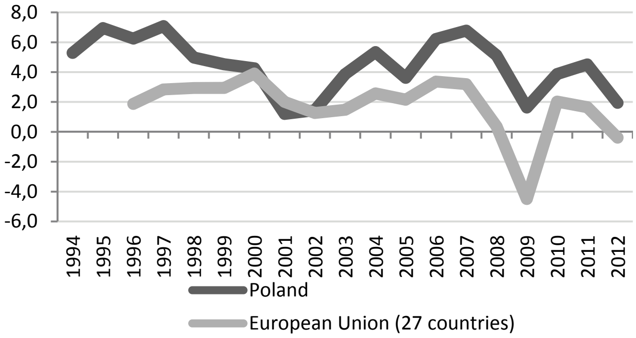

Figure 1 GDP, volume – annual growth rates in percentage in Poland and EU
Source: OECD

Maintaining financial liquidity is a priority task of every entrepreneur. Enterprises in Poland clearly indicate problems of lack of liquidity. As data from Fig. 2 shows, liquidity problems grow in periods of economic decline. During a crisis, the percentage of enterprises that suffer from lack of working capital increases even by around 10%. Entrepreneurs relatively best service bank debt – over 90% of Polish enterprises do not indicate problems with settling credit installments. It is much worse with the servicing of non-banking debt, in particular goods and services delivery debt. Only 60-65% of enterprises are able to settle such debt without difficulty. Among the reasons for such a situation are not only economic factors, but also legal ones, and even an economic practice of deliberately suspending payments as enterprises are not concerned about possible restrictions applied by the creditor.

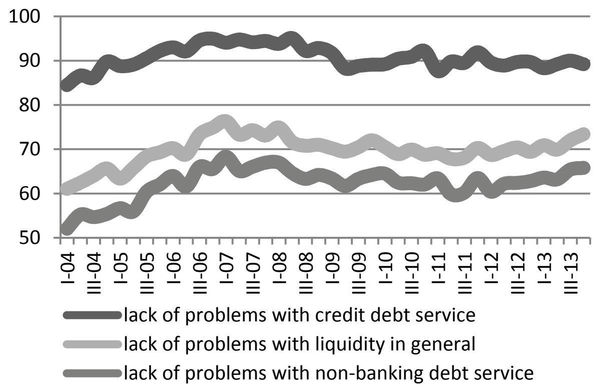

Figure 2 Problems with liquidity in Polish enterprises *in percentage*
Source: The National Bank of Poland

Current liquidity ratio is a basic measurement indicating current solvency of enterprises. It is assumed that its minimal limit value should be 1.5. From this perspective, we can say that the business sector in Poland is characterized by too low liquidity (Fig. 3). However, the long-term trend shows gradual increase in liquidity in the business sector, although clear differences are visible in the individual sectors of the economy. We can also see slightly deteriorating levels of current ratio in the periods of worse economic situation.

Growing current liquidity and gradually increasing share of fixed capital in financing current assets (from 2% in 2001 to 17% in 2012) shows that Polish enterprises are gradually resigning from a highly aggressive strategy of managing liquidity, which largely results from objective causes, such as: small amount of working capital and non-accessibility of long-term financing. The current strategy of liquidity management can be basically described as almost moderate. Liquidity measurements are designed to provide information about the paying ability and financial flexibility of the firms. In particular, the firm's creditors are interested in the ability of the company to pay off its short-term obligations until their maturity.

Another element in the area of current corporate finances that needs to be analyzed is quick liquidity ratio. There is a long-term growth in the level of quick ratio of Polish enterprises. Significant increments are visible especially after 2002 (Fig. 4). Analysis of the quick ratio shows that its level in the last few years is slightly above the minimum (1,0).

4. CONCLUSION

The world in which real firms function is characterized by the firm's considerable uncertainty regarding the demand, market price, quality, and many other factors. Information is costly to obtain, and the firm is faced with limits on the productions capacity and technology that it can employ (Scherr, 1998).

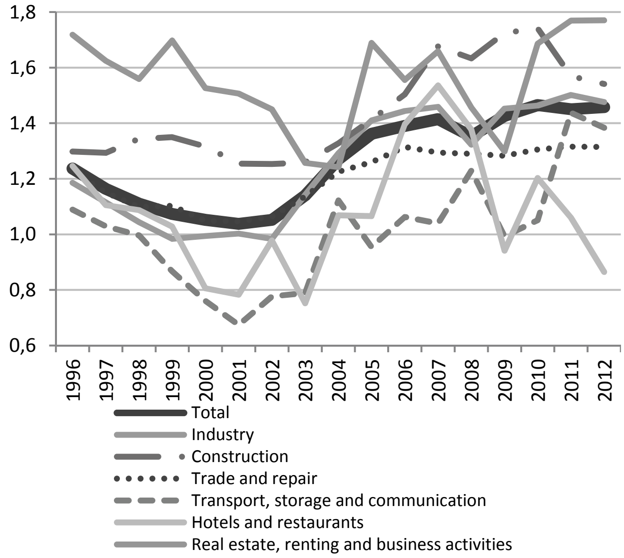

Figure 3 Current ratio in enterprises in Poland
Source: Central Statistical Office in Poland

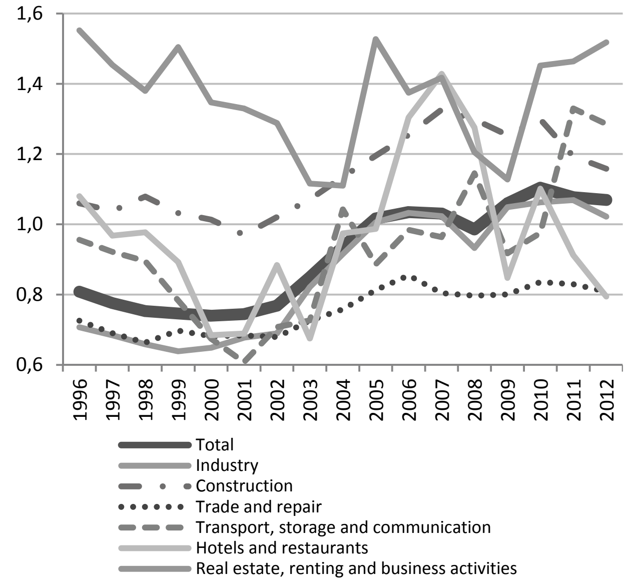

Figure 4 Quick ratio in enterprises in Poland
Source: Central Statistical Office in Poland

Similar uncertainty can be seen in the macroeconomic environment, which the financial crisis after 2008 clearly proved. It is necessary for enterprises to deal with the new economic reality and to develop new methods and forms of management. Decisions concerning liquidity impact the risk of an enterprise operation. This risk involves shutting down production or sales processes or inability to repay liabilities based on the most liquid assets. Thus, it is important that financial managers have possibly most extensive knowledge about effective liquidity management.

Literature of the subject emphasises variety of factors refering to the firm's liquidity. Part of them are macroeconomic factors which are connected with the economic situation in a given period. Economic recovery is a period of growing turnovers of companies, increasing investments and easier access to sources of financing. Expected sales growth usually requires appropriate increase in operating current assets. This is possible by obtaining long-term interest financing. Whereas, as shown by Tăgăduan (2011), in conditions of economic crisis, the policy of the working capital should be adapted to new requirements. This way the whole strategy of financing the operating cycle should be modified in the sense of increasing the share of financing on the basis of the own capital towards the policy adopted during favorable economic conditions, when the accent is mainly on financing mostly from attracted sources. There is, thus, no doubt that macroeconomic environment has an impact on an enterprise's finances. However, the direction and strength of this impact should be analyzed and assessed on a continuous basis so that managers could take into account the risk of the impact of the environment when managing finances, including liquidity management.

Polish enterprises undoubtedly suffer from low current liquidity and insufficient working capital, which can lead to periodical limitation of current operations, and in extreme cases – even to the collapse of an enterprise. This situation is the result of their financial situation and situation on the market. It should be stressed that improvement of the economic situation in Poland will undoubtedly lead to the improvement of the operating performance of enterprises.

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