CURRENT RATIO

1. Current Ratio Calculator

The current ratio helps assess whether a business can meet its short-term obligations using its current assets.

Even profitable companies can face financial trouble if receivables and payables fall out of sync. Fast-growing companies often experience cash flow issues as they require more working capital to support operations like inventory and payroll.

2. What is the Current Ratio?

It is the ratio of current assets to current liabilities. It reflects a company's short-term financial strength.

Current assets include cash, short-term investments, prepaids, receivables and inventory

Current liabilities include short-term debt, accounts payable, bank credit lines, accrued expenses and taxes payable.

3. What is a "Good" Current Ratio?

Banks usually prefer a Current Ratio above 1.0, ideally 1.2 and 2.0 is considered solid. The index below the industry average may signal higher financial risk.

Some companies choose to keep it even higher (e.g.2 or 3) for extra security, especially in uncertain times. However, an excessively high ratio could suggest that the company isn't using its assets efficiently.

To sum up, the ideal ratio balances liquidity and efficiency, depending on the company's strategy and risk tolerance.

4. Why use the Current Ratio?

The current ratio measures whether a business plan can meet its short-term obligations using its current assets. Regular monitoring (monthly or quarterly) helps identify issues early, before they become serious.

5. Example of a Current Ratio Calculation

A coffee shop gets paid daily and uses that cash to cover wages and supplies. Since money flows in and out quickly, the current ratio around would be fine.

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On the other hand, a software company may only get paid after completing a project. With ongoing expenses and delayed income, a higher current ratio is safer.

6. How do you calculate the current ratio using a balance sheet?

To calculate the current ratio, divide a company's current assets by its current liabilities. These figures can be found on the balance sheet

Example

Imagine a clothing retailer with 90.000€ in current assets (like cash, inventory and receivables) and 60.000€ in current liabilities (like supplier payments and short-term loans)

Therefore,

$$\boldsymbol{Current\ Ratio} = \frac{90.000€}{60.000€} = \mathbf{1.5}$$

This means that the company has 1.50€ in short-term assets for every 1 € it owns, showing good liquidity.

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