

QUICK RATIO (ACID TEST RATIO)

The Quick Ratio shows how easily a company can pay its short-term debts without selling its stocks. To do this, it looks only at assets that can be quickly converted into cash, such as cash on hand, accounts receivable from customers and other readily realizable assets.

This indicator is important because it shows the company's true liquidity and its ability to meet immediate financial needs without relying on the sale of inventories, which may take longer.

1. How to calculate the Quick Ratio?

$$\text{Quick Ratio} = \frac{\text{Available Assets}}{\text{Current Liabilities}}$$

2. What should I include in the Quick ratio calculation?

Available Assets	Current Liabilities
Cash	Salaries payable
Treasury bills	Accounts payable
Money Market mutual funds	Credit card balances and lines of credit
Healthy accounts receivable	Current portion of long-term debt
	Accrued expenses

TABLE INTERPARTION

Cash :40.000 €

Accounts receivable and other receivables:35.000 €

Current assets 40.000 €+35.000 €= 75.000€

Current liabilities: 90.000 €

Therefore

$$\text{Quick Ratio} = \frac{\text{Available Assets}}{\text{Current Liabilities}} = \frac{75.000\text{€}}{90.000\text{€}} = \mathbf{0.83}$$

Interpretation: A Quick Ratio of 0.83 that the business has 0.83€ in liquid assets for every 1 € of short-term liabilities. This suggests that the company may not be fully able to meet its immediate obligations using only its most liquid assets, which could indicate limited short-term liquidity.

3. Interpreting the Quick Ratio

A Quick Ratio is a key liquidity indicator that shows whether a company meet can meet its short-term obligations using only its most liquid assets like cash, short-term investments and accounts receivable.

A low Quick Ratio (below 1.0) may signal that the company is at risk of running short on cash when immediate payments arise. This can affect supplier relationships, employee payments and the ability to seize short-term opportunities.

A high Quick Ratio (above 1.0) indicates strong liquidity, but if it is too high, it may suggest underutilized capital. Rather than holding excessive cash or receivables, a company might be better off reinvesting that capital into operations, innovation or market expansion.

4. What is a “Good” Quick Ratio?

A Quick-Ratio of around 1.0 is generally seen as stable. It means the business has enough liquid assets to cover short-term liabilities. A ratio of 0.8 or lower could indicate balance sheet weakness, while a ratio significantly above 1.5 might suggest overly conservative capital usage

5. What explains an increase or decreases in the Quick Ratio?

Changes in the Quick Ratio are mostly driven by changes in liquid assets or current liabilities.

Example 1st : Increase in liquid assets (higher cash)

Cash: 15.000€

Receivables: 50.000 €

Total Quick Assets: 15.000€+50.000 €=65.000 €

Current liabilities:60.000€

Therefore,

$$\text{Quick Ratio} = \frac{65.000 \text{ €}}{60.000 \text{ €}} = 1.08$$

The Ratio improved because your available assets increased

Example 2nd : Drop in liquid assets (less cash)

Cash: 3.000€

Receivables: 47.000 €

Total Quick Assets: 3.000€+47.000 €= 50.000 €

Current liabilities:60.000€

Therefore,

$$\textbf{Quick Ratio} = \frac{\textit{Available Assets}}{\textit{Current Liabilities}} = \frac{50.000 \text{ €}}{60.000\text{€}} = \textbf{0.83}$$

The indicator decreased due to a decrease in available cash.

6. What is the difference between the Quick Ratio and the current Ratio?

The Quick Ratio is generally seen as a more accurate indicator of a company's ability to meet short-term obligations compared to the current ratio. This is because the quick ratio excludes inventory and prepaid expenses, which are not always easy to convert into cash quickly.

While the current ratio includes all current assets, the quick ratio focuses only on those that are truly liquid, like cash and receivables. That is why the quick ratio is often used to complement the current ratio.

7. Why does the quick ratio matter?

The Quick ratio gives a clearer view of short-term liquidity because it excludes inventory and prepaid expenses, which may not turn into cash quickly.

The current ratio includes all current assets, even less liquid ones, so it may look stronger than the real situation.