Accounting measures of corporate liquidity

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International Journals Review Jstore. org Journal Review #1 Accounting Measures of Corporate Liquidity, leverage and costs of financial distress. Teresa a john Synopsis: When the cost of financial distress is high in a firm that firm may maintain a large amount of its total asset as liquid asset and be careful on taking debt. This journal has talked about the relation on the financial distress the cost of corporate liquid policy and the leverage policy of the firm. Liquid asset constitute a significant portion of the total asset of the major corporations of U.

S. Using different proxies to direct and indirect cost at different financial distress the relationship between corporate liquidity is examined. The bondholder's coupon debt claims are considered as the firm's hard contract as they will be in violation of contract if the coupon payments are not made on time. On the other hand the common stocks and the preferred stocks are considered as the soft contract as the payout in such cases can be suspended on unfavorable situations.

Meeting the hard contracts will be the more important thing every case. A firm is in financial distress at a given period of time if its current assets such as cash and marketable securities are not enough to meet the current liquidity requirements of the hard contracts. So the mechanism of avoiding the financial distress depends on whether to increase or better the firm's current liquid asset or try to remove the hardness of the contracts as much as possible.

In the journal the author construct two hypothesis where H1: " The proportion of liquid asset invested liquid asset (cash and marketable

securities) will be increasing in costs of financial debt” and H2: “ The proportion of debt in the capital structure of a firm will be decreasing in its cost of financial distress”. Journal Review #2 Liquidity and Firm Investment Outlays Norman V. Breknner Synopsis: If own assets are sold to pay down debt then the value lost will be tangible as well as intangible such as growth opportunities, monopoly power operating synergies etc.

It actually destroys the going concern value of the firm. Normally the debt covenants puts a barricade to sell the asset of the firm but if the firm can convince the bankruptcy judge that the asset sale was necessary to meet the demand of money then it will be allowed. Firms that produce specialized product incur more cost in liquidation of the asset. For these companies sometimes in the prospect of future financial distress they used up their advertising and R & D expenditure. These costs can be minimized if firms maintained its solvency by maintain higher liquidity.

The liquidation cost is understably higher for firms with high R & D and advertising. The liquidity cost of asset restructuring is negatively related to ‘ Collateral value’ assets. Firms with assets of high collateral value need to maintain a low level of liquidity. Cost of financial distress may not be the only reason for the relationship between corporate liquidity and variables such as R & D and advertising expenses, R & D and advertising expenditure may contribute in building up of assets and resources characterized by asymmetric information between corporate insiders and outside investors in the market.

In the second part it is found that firms with large cash inflows or higher operating income requires less external financing and less debt financing or less borrowing. So in conclusion we can say that corporate liquidity maintained is increasing in proxies of financial distress costs and its decreases in the collateral value of the assets and other sources of liquidity available such as projected cash flows, intermediate cash flows , sources of borrowing and the cash cycle. Finally we can say that there is positive relationship between the optimal liquidity maintained by a corporation and the cost of liquidity of its assets.

These costs include cost of distressed asset sales and loss of going concern value in liquidation and there is a negative relation between corporate leverage and the financial distress cost. Firm's investment outlays may depend on its liquidity to some extent. This journal has focused on finding the link and established a clear relation. Investment expenditure was positively related to firm's liquid asset holdings for both a three year period of moderate income decrease and a two year period of very quick income turn down. No single relationship was located for the two-year interval.

The marginal rate of risk rises with the amount invested because of different unfavorable outcome. Additional loans are changed with the rise in marginal risk. This is similar to the rising marginal cost of output. However, the more amount invested the less is the marginal risk as it implies less danger to the wealth of creditors and the firms. Therefore, the firm's investment depends hugely on the size of the firm's asset. A relationship between the firm's investment outlays and liquidity under uncertainty is consistent with the analysis of the variation of it.

But in the event of loss utility of the investor depend on the net liquidity position as low liquidity position of an investor may force him to liquidation of his inventories and other current assets. A quite different line of argument may suggest there is a positive relationship between liquidity and investment. The firm may act as if it has past pattern of receipts or assets that has allowed it to keep a low ratio of liquid to capital asset. In such cases firms will invest low asset and rebuild liquidity. On the other hand firm's with large initial fund will invest in order to convert it to real capital.

From an experiment of forty two southern Minnesota firm the analyst found that the variation of income over shorter period like two or three years hasn't change the investment format of the firms. By using " Firms liquid asset" and " Non firm liquid asset" as two variables it was found that " Investment" being the dependent variables was significantly related with the firm' s both the two liquid asset. These findings indicate that liquidity have some effect on the firm's investment outlays during a period dominated by a decline from the preceding period.

The interpretation can be during falling income lender's confidence fall. As a result firm has less fund to invest as marginal rates on current borrowings rise at a rapid rate. In such case importance of the firm's own liquidity increases. If net liquidity is high firm could still meet the claims and avoid forced liquidation. If current liquidity is high then firms needs to liquidate its inventories and other current asset. Possibly bankruptcy is somewhat related to liquidity. Creditors may be more likely to force under a firm in a low net worth position if the firm can make some satisfying return of the current claims.

Firms that have build up strong liquid position in a period will be in a strong position in the later period of declining income. They will lead to a lower asset accumulation than the firms of lower liquidity. It has seen that firms that have kept lower liquid asset in order to build capital asset are finding it desirable to invest low and rebuild liquidity. On the other hand firms that have kept a higher liquidity in previous period eventually becoming as heavier investor. So , we can say that liquidity and investment are directly related in both the period of rising and declining sales.