

LIQUIDITY RATIO



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These days most people go for regular health check-ups in order to stay fit. During one such check-up, my friend was told that his blood sugar levels were higher than the normal range.



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Thus the reading of his sugar level became an indicator that he should change his lifestyle, diet and exercise plans.



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Just as there are indicators which give us an idea of our health, there are indicators like Liquidity Ratio that give us an idea about our financial health too.



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One such liquidity ratio (also known as acid test ratio) gives us an idea about how well prepared we are to meet our emergency needs or short term obligations.



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- To illustrate, it indicates the number of months you can manage your expenses in case of a job loss where income stops.
- **Liquidity Ratio = Liquid Assets/ Immediate Monthly Expenses**
- **Liquid Assets include any cash that you may have stashed away in your savings bank accounts or elsewhere, or savings in fixed deposits or liquid funds.**
- **Equities and Mutual Fund investments are usually not seen as liquid assets as they are subject to market movement.**



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Immediate monthly expenses include rent or equated monthly instalments (EMIs), if any. In other words, expenses that cannot be delayed.

On the other hand, insurance premiums or living & lifestyle expenses constitute outflows that can be delayed by a certain degree.



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1. For example, if your liquid assets are Rs 2 lacs.
2. Say your monthly expense is Rs 1 lac.
3. Then your liquidity ratio as per the formula would be $2/1 = 2$.



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A liquidity ratio of 2 means that you can provide for 2 months of expenses without earning an income.



**So what is the right number for
the liquidity ratio?**



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1. It is dependant from individual to individual.
2. If a person has a large income and relatively low expenses he need not have a high liquidity ratio.
3. On the other hand if a person does not have a steady flow of income, he should have a higher liquidity ratio.



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Hope this lesson has succeeded
in clarifying the significance of
Liquidity Ratio

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**Mutual Fund investments are subject to market risks,
read all scheme related documents carefully.**

