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Настоящий сборник предназначен для преподавателей, магистрантов, докторантов, а также исследователей, интересующихся практикой современного бизнеса, менеджмента, препринимательства в Казахстане.

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СОДЕРЖАНИЕ

DARITHANA

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On July 13, 2013 Serik Junn, the CFO of Darithana ("The Company") had received an official request from Future bank of Kazakhstan ("The Bank") for the immediate repayment of all amounts due under the loan agreement. Darithana was a listed company of generic and branded drugs in Kazakhstan, Eurasia. Its domestic market share was more than 50% among Kazakhstan's manufacturers.

The basic terms of the loan agreement were:
(1) the loan would be used to replenish current assets;
(2) the maturity date would come after one year with an annual interest rate of 6.75 %;
(3) the loan collateral was required to maintain the Current Ratio of not less than 1.5.

However, by the beginning of July 2013 this ratio had dropped to 1.28. This gave the Bank the right to demand repayment of the loan. But the Company currently did not have sufficient funds to meet its urgent obligation to the Bank.

The same evening, Serik was unpleasantly surprised by a National Broadcasting Company's report that Darithana's staff had not been paid in full during the last few months. In fact, the Company incurred debt for its employees' wages which it tried to keep a secret. This report would have a negative impact on Darithana's business image and its relations with investors. Moreover, it would also attract the attention of the government's health and safety inspectors.

The Company's liquidity problems had been linked to the implementation of a major investment project which cost $66 million over a five year period. The project included (1) construction of a new ampoule factory and (2) the transfer of all production capacities to a standard of "Good Manufacturing Practice".

The next day, Serik had looked at the Company's balance sheet again, focusing on the short-term assets and liabilities. He was interested in the financial data at the time of the loan (01/07/2012) and the time of the Bank's requirement to return the entire debt (01/07/2013). Below was what he saw:

	$000	
	01/07/2012	01/07/2013
Cash and cash equivalents	9 298	4 630
Trade and other accounts receivables	16 081	24 649
Inventories	21 968	27 283
Other current assets	3 275	3 141
Total current assets (1)	*50 622*	*59 703*
Current portion of long term loans	-	22 172
Short-term loans	14 403	8
Trade and other payables	13 448	19 550
Liabilities under other mandatory and voluntary payments	23	-
Employee benefit liabilities	-	50
Tax liabilities	43	-
Other current liabilities	1 930	4 693
Total current liabilities (2)	*29 847*	*46 473*
Current Ratio (1) / (2)	1.69	1.28

What financial decisions should Darithana take to cover these two urgent liabilities: to the Bank and to its employees?

DARITHANA

This note serves as a facilitator's guide to the Darithana case study. After a brief case synopsis, the note describes the learning objectives and key lessons. Assignment questions are listed and a teaching plan to guide the discussion and answer the questions is presented.

Case Synopsis

Darithana, a listed company of generic and branded drugs in Kazakhstan, faced the two urgent liabilities: (1) the Bank's requirement to repay its loan ahead of time because of its inability to meet the requirement to the Current Ratio and (2) debts on employee wages. But the Company currently did not have sufficient funds to carry out these obligations. Its liquidity problems had been linked to construction of the new factory within the Company's long-term investment project that needed cash outflows. What financial decisions should the CFO Serik Junn take to cover these two urgent liabilities: repay the debt to the Bank and pay the employees?

Learning Objectives

This case is best used as the introduction to the Ratio Analysis or Financial Reports & Analysis, especially on Liquidity Ratios. The case can also be used to assess the financial policy of a company and its creditworthiness. It can also raise another issue of international and national scales of financial rating for companies and their financial instruments (e.g. bonds).

The purpose of this case is to stimulate students' discussion on the following issues:
1. Current Ratio (CR) concept
2. The structural analysis of short-term assets and liabilities
3. The approaches to standard values of Current Ratio
4. The two types of financial policy

Suggested Lesson Plan

Activity	Instructional Strategy	Duration (min)
Class discussion	Class discussion	50
Break		10
Lecture on Liquidity Ratios and a company's financial policy	Lecture	50
		110

Students Discussion Questions:

1. What should the CFO do to meet urgent liabilities?

2. Why does the Bank require the Current Ratio to be greater than 1.5?

3. How would you describe the Bank's financial policy: conservative or aggressive? What happens if you attract long-term sources and which kinds of them (e.g. loans, bonds, etc.)?

4. How is the Current Ratio linked to a company's long-term solvency?

Case Analysis and Teaching Plan

1. What should the CFO do to meet urgent liabilities?
Students should contribute to the discussion here. If students have not read the case, listing issues allows them to catch up and hence be participative in the discussion. The students will typically advocate the two quite obvious solutions:

1. Request the Bank to give additional time to increase liquidity.

2. Communicate with the staff and ask them to be patient by promising to promptly pay all salary debts.

The instructor should support these possible solutions. However, you should tell the students that such approaches do not always work and do not provide long-term effect. For example, if the Bank has any financial difficulties itself, it may simply reject the Company's request. Then you could ask the students to name a few other options when the above two offers do not work.

2. Why does the Bank require the Current Ratio to be greater than 1.5?
The instructor could focus the students' attention to the Current Ratio's formula and ask students: "*What do you think, why does the Bank require the Current Ratio to be greater than 1.5?*" This question allows you to elaborate on the problem of the ratio's optimal value and its essence.
In explaining of the Current Ratio's role, it would be useful to write on the blackboard the formula as shown in **Figure 1** in order to help the students visualize it:

Figure 1: Current Ratio

$$CR = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\begin{array}{l}\text{(1.1) Cash and cash equivalents}\\ \text{(1.2) Trade and other accounts receivables}\\ \text{(1.3) Inventories}\\ \text{(1.4) Other current assets}\end{array}}{\begin{array}{l}\text{(2.1) Short-term financial liabilities}\\ \text{(2.2) Trade and other payables}\\ \text{(2.3) Liabilities under other mandatory and voluntary payments}\\ \text{(2.4) Employee benefit liabilities}\\ \text{(2.5) Tax liabilities}\\ \text{(2.6) Other current liabilities}\end{array}}$$

Theoretically, this short-term coefficient reflects how company's current liabilities are covered by current assets. Using Figure 1, you could draw students' attention to the fact that the ratio shows how much of a company's current debt can be repaid through available cash, future payments from debtors as well as on condition of selling of existing inventories, including finished products and other tangible current assets. In other words, short-term liquidity measures are typically based on "*how quickly assets can be converted into cash to settle obligations that are due soon*"

Excess of current assets over short-term financial liabilities provides a reserve stock to compensate for losses that may be incurred by companies when placing current assets, except cash. The higher the margin, the greater the confidence of creditors that the debts will be paid. Typically, the recommended value, especially by banks, is ≥ 2.

To visualize, it would be useful to calculate the company's assets percentage and changes over the period.

					$000
	01/07/12	%	01/07/13	%	Changes (4-2)
A	1	2	3	4	5
Cash and cash equivalents	9 298	18,37	4 630	7,75	-10,62
Trade and other accounts receivables	16 081	31,77	24 649	41,28	+9,51
Inventories	21 968	43,39	27 283	45,71	+2.32
Other current assets	3 275	6,47	3 141	5,26	-1,21
Total current assets (1)	*50 622*	*100,00*	*59 703*	*100,00*	-

At this point you could ask, "*What is the liquidity of each item of current assets?*" starting with cash. Guide the students with the following examples:

1. The more cash, the more guarantee of debt repayment. However, there exist no common standards and recommendations for the ideal level to cash a company should hold because a company with even a small sum of cash could always be financially solvent if it is able to balance and synchronize cash inflow and outflow efficiently and on time.

2. If most assets consist of accounts receivable, which is difficult to collect, then it would likely require a higher ratio of assets to liabilities, and vice versa.

Students could extend this list.

You could conclude the discussion that the single correct value or guideline of Liquidity Ratios (including Current Ratio, Cash Ratio and Quick Ratio) does not exist. In each case, it may be different depending on the company's financial position and specific external situations. In analysing the company's financial ratios, it would be useful to establish benchmarks that you could use to compare its relative performance, for example, against its industry or its previous years' ratios.

Here it is relevant to point out that the usual recommended value of CR is greater than 1. Depending on the industry and other business specification, this recommendation may vary.

Discuss the other side of a Current Ratio - what kinds of liabilities does a company have to pay? For clarity, students need to compile the similar table on the structure of current liabilities and its changes over the period, by posting information on a separate board, but next to current assets.

					$000
	01/07/12	%	01/07/13	%	Changes (4-2)
A	1	2	3	4	5
Current portion of long term loans	-	-	22 172	47,71	+47,71
Short-term loans	14 403	48,25	8	0,02	-48,23
Trade and other payables	13 448	45,06	19 550	42,07	-2,99
Liabilities under other mandatory and voluntary payments	23	0,08	-	-	
Employee benefit liabilities	-	-	50	0,11	+0,11
Tax liabilities	43	0,14	-	-	-0,14
Other current liabilities	1 930	6,47	4 693	10,10	+3,63
Total current liabilities (2)	*29 847*	*100,00*	*46 473*	*100,00*	-

Analyzing the table, you could ask the question "*What are the two essential changes that took place in*

the structure of the company's liabilities over the period?" Students undoubtedly note the following:

1. The appearance of the balance sheet item "current portion of long term loans" which amounted to 47.71%.

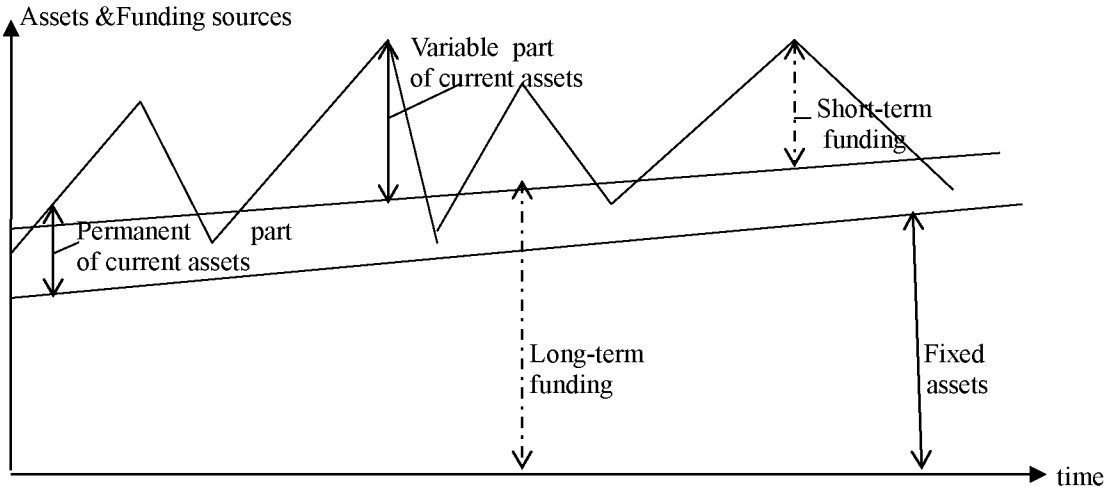
2. The emergence of employees' wage debts.

The first element would enable you to ask the following question: "*Could the CFO bring long-term sources to meet current liabilities?*" and move on to discuss legitimacy of company's financial policy when it attracts short-term loans for long-term financing of the construction of a new plant. This will begin to acquaint the students with the differences between conservative and aggressive financial policy of a company.

3. How would you describe the Bank's financial policy: conservative or aggressive? What happens if you attract long-term loans and which ones?

Within the third question, it may be useful to use **Figure 2** for explanation of the differences between company's conservative and aggressive financial policies.

Figure 2: Sources of funding



Explanation for the Figure 2 could be the following:

The permanent part of current assets is the minimum needed to carry out enterprise's operating activity and its value does not depend on seasonal fluctuations in output and sales. As a rule, this part is fully financed by equity capital and long-term borrowings.

The variable part of current assets is subject to fluctuations due to seasonal change in the company's activity. Usually it is financed by short-term borrowed capital as well as in a conservative approach - partially by equity.

You could show in the Figure 2, *how to distinguish between two basic types of financial policy.*

A conservative financial policy is the behavior when a company uses long-term financing to cover a part of current assets. The higher the line of long-term financing on the graph, the more conservative will be the financial policy of the company, and costs will be higher.

An aggressive financial policy is the opposite of a conservative one. In this case, a company's

permanent current assets are financed by short-term loans. As a result there could be a negative effect of collateral for loans and a constant need to refinance its loans by the end of the period, which could lead to additional risks.

Here it would be appropriate to engage students into a discussion with the question: "*To what type of financial policy could you attribute Darithana's policy? What are the additional risks of short-term financing? How is it possible to reduce these risks?"*

Most likely, the students would say that the company's policy was aggressive as Darithana currently had to look for other sources of short-term financing to repay the two urgent liabilities.

Among the possible additional risks of short-term financing students may include the following:

(1) The shorter period of payments on a schedule, the greater the risk that a company would not be able to loan repayments and interests on them.

(2) Cash flows from fixed assets erected due to short-term financing are likely to be insufficient for the return of loans and there would be a risk that a creditor refuses to prolong maturity of a loan.

(3) In the short-term lending there could be a high risk associated with increasing interest rates on subsequent loans.

(4) When you refinance short-term loans during the period of rising interest rates, the amount of interest paid might be greater than service payments of long-term loans.

If you are extending the case, this is an ideal point to bring up the next question: *"How could we maintain the necessary level of collateral for a loan?"* Possible student responses could be the following:

(1) by increasing the proportion of liquid assets, which could reduce risks of insolvency;

(2) by requesting the Bank to change or extend the maturity schedule.

4. How is the Current Ratio linked to a company's long-term solvency?

The instructor should guide the students in following direction: the requirement to maintain the Current Ratio at a certain level has a deep theoretical. The interpretation of this ratio connected with an important hypothesis about the correct arranging financing: companies do not use short-term sources of financing for the acquisition of long-term assets.

To clarify this hypothesis, it would be useful to go back to the board with the formula of a Current Ratio (Figure 1) and transform it.

Figure 1: Current Ratio

$$CR = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\begin{array}{c}\text{Total Assets } \textit{minus} \text{ Non-Current Assets} \\ \textit{OR} \\ (\text{Current Liabilities } \textit{plus} \text{ Non-Current Liabilities } \textit{plus} \text{ Equity}) \\ \textit{minus} \text{ Non-current Assets}\end{array}}{\text{Current Liabilities}}$$

Or after transformation:

Figure 1: Current Ratio