

they need to reduce their liabilities or increase their assets. This may motivate Next to invest in big projects in order to increase their assets.

Acid Test Ratio

The acid test ratio shows the company's assets as compared to their liabilities. This shows Next how well their business can meet its liabilities without having to sell stock.

Acid test ratio = $\text{current assets} - \text{stock} / \text{current liabilities}$

NEXT

Current assets – stock = $£23.5\text{m} - £7.4\text{m} = £16.3\text{m}$

Current liabilities = $£331.8\text{m}$

$£16.3\text{m} / £331.8\text{m} = £0.05$

This is not a good ratio as it shows that there are too many liabilities to cover their assets. To improve their ratio, Next need to reduce their liabilities or invest in assets to bring their ratio closer to 1. A good acid test ratio should be 1 or near around that, but no higher than 2 as this would mean wasting money on assets.

Next PLC can use the acid test ratio to understand their financial state in regards to their assets, stock and liabilities. They can clearly see that they need to reduce their liabilities in order to cover their assets. To do this, Next need to bring their acid test ratio to around 1 but shouldn't go over that and should stay well away from 2 as this means they have too much money spent and wasted on their assets. They need to make sure they invest wisely to cover their assets.

Preview from Notesale.co.uk
Page 2 of 2