

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, ECONOMICS & MANAGEMENT

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**THE STUDY OF SOLVENCY POSITION OF MUMIAS SUGAR COMPANY LIMITED, KENYA**

**OMBEGA OGUTA KEPHAR**  
**RESEARCH SCHOLAR**  
**DEPARTMENT OF BUSINESS AND ECONOMICS**  
**JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**BONDO**

**ABSTRACT**

*This paper investigates the solvency performance of Kenya's leading sugar industry for the period 2009 - 2013. Financial ratios are employed to measure the liquidity and credit quality performance of Mumias sugar Company. The study reveals that overall liquidity was favourable since there was greater claim of shareholders over the assets of the company than those of the creditors in the long run of its operation.*

**KEYWORDS**

Analysis of short term, long-term liquidity position.

**INTRODUCTION**

Every business should have sufficient working capital to survive on its short run operations and in long run to grow. Any business has to ensure optimum utilization of four factors of production such as land labour capital and organization to maximize its net assets. It is essential for a financial manager to analyse the solvency of the firm to ensure to achieve the one the goals of the firm i.e. maximize the net asset of the firm. The ability of the firm to meet its short term as well as long term obligation to its creditors, to ensure a reasonable return to its owner and secure optimum utilization of the assets of the concern. Failure to maintain adequate liquidity in an enterprise it can lead to a portion of working capital being financed by long term funds. Solvency analysis is an important activity of evaluating financial soundness of the companies. The effective management and control of various components of short term funds has direct impact on liquidity of the enterprise.

**STATEMENT OF PROBLEM**

"The analysis of financial solvency of the Mumias Ltd Company aimed at disclosing short and long term liquidity of the business."

**OBJECTIVES OF STUDY**

1. To measure short – term and long – term solvency of the business.
2. To compare inter-period financial position and revelation of trend in liquidity of the company.
3. To forecast future potential of the company.

**TOOLS FOR THE ANALYSIS**

The study employed financial ratios both for short-term and long-term, specifically:

1. Current ratio
2. Liquidity ratio
3. Fixed asset ratio
4. Debt equity ratio and
5. Capital gearing ratio

**LIMITATION OF STUDY**

1. The study is only applicable to Mumias Sugar Company.
2. The study is based on historical data
3. Financial statement does not always disclose the correct financial position of a business concern as they are influenced by the personal opinion.
4. Balance sheet of the company is a static document as it discloses the financial position of the company on a particular date, but the value shown and composition of item keep changing day by day and information does not disclose current realities.
5. Financial statement of one period may not be comparable as such with statements of other periods due to difference in condition and change in economic situations.

**PERIOD OF STUDY**

The study covers a period of five financial years as from 2009 to 2013.

**METHODOLOGY OF STUDY**

The methodology employed on the analysis of solvency of Mumias Sugar Co. Ltd is based on secondary data. The secondary data was mainly collected from Annual reports, Interim records, Company journals, News papers, Company web site.

**ANALYSIS AND INTERPRETATION****CURRENT RATIO ANALYSIS**

The company's Current ration expresses relationship that exists between current assets and current liabilities and can be calculated by dividing current assets by current liabilities.

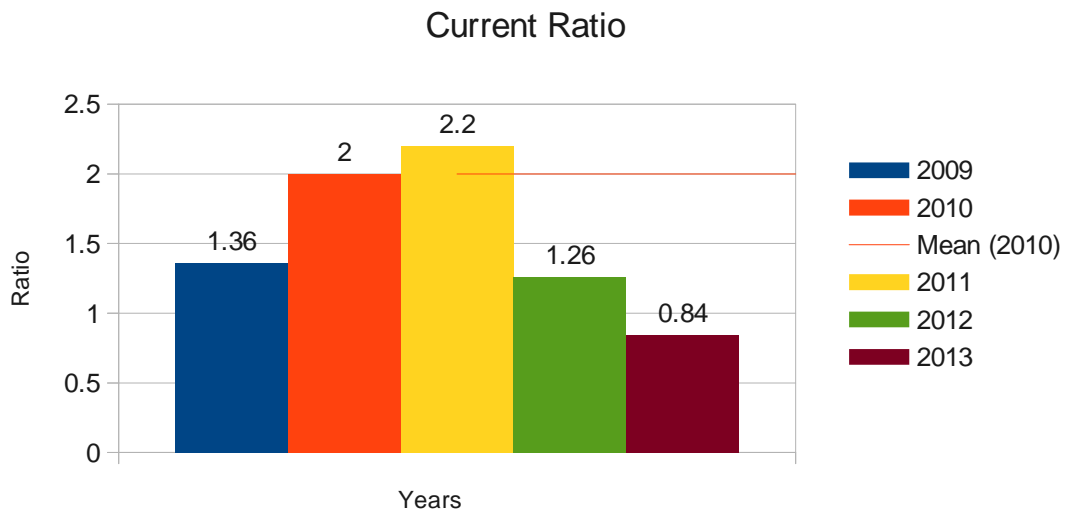
The relation help to measure the short term solvency of a business. In a sound business a current ration of 2:1 is considered an ideal one.

**TABLE 1**

Years	2009	2010	2011	2012	2013
Current ratio trend.	1.36	2.00	2.20	1.26	0.84

Sources: Computed data from Annual Reports

FIGURE 1



**INFERENCE**

- ➔ The year 2009, 2012 and 2013 the business's current ration is below the ideal ration, which indicates that Mumias sugar company's short term solvency is doubtful and it's evident the business was not in position to meet its current liabilities in time as and when they are due to mature.
- ➔ The year 2010 the business attained the ideal ration on its liquidity which discloses caution and provides flexibility for payment.
- ➔ The year 2011 the displays a high ration, a greater margin of safety to creditors. However, from the management point of view such a higher ration indicates poor planning since a excessive funds are invested in current assets and lies idle. This is an indication that Mumias sugar has less efficient use of funds, which shows how it does depend on long term source of raising funds which are expensive than current liabilities.

**QUICK/LIQUID/ACID TEST RATIO ANALYSIS**

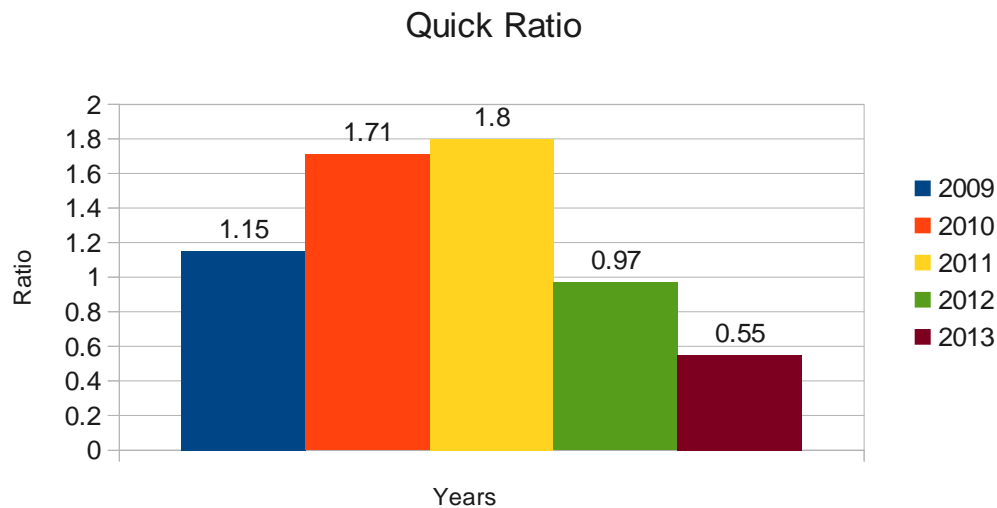
Its a ration of a more refined measure of Mumias's business solvency. Which could establish the relationship between liquid assets and current liabilities. Can be calculated by dividing quick assets by current liabilities. The ideal liquid ration or generally accepted norm for liquidity ration is '1:1'.

TABLE 2

Years	2009	2010	2011	2012	2013
Quick ratio trend.	1.15	1.71	1.80	0.97	0.55

Sources: Computed data from Annual Reports

FIGURE 2



**INFERENCE**

The year 2012 and 2013 indicates that the ration is below the ideal which shows that Mumias sugar had a bad liquid position. The year 2009, 2010 and 2011 the ration was above ideal which indicates current assets convertible easily to cash.

**ANALYSIS OF VARIANCE ON SHORT TERM SOLVENCY (Current ratio and Quick ratio)**

TABLE 3: ANOVA TABLE

Source of Variance	Sum Square	Degree of Freedom	Mean Sum Square	Variance Ratio
Between column	SSC= 0.22	1	0.22/1 = 0.22	F = MSE/MSC
Within column	SSE= 2.33	8	2.33/8 = 0.29	= 0.29/0.22
Sum Square Total	SST= 2.55	9		= 1.32



Degree of freedom is 1,8  
 $F = .29/.22 = 1.32$   
 Table value at 5% level = 5.32  
 H0 accepted since  $F < \text{Table value}$ .

**INFERENCE**

Thus there is no significant difference between the ratios i.e current and quick ratios.

**FIXED ASSET RATIO ANALYSIS**

The company could be in position to establish the relationship between its fixed assets and long term funds. The objective of the ration is to ascertain the proportion of long term funds invested in fixed assets. The ideal ration should be '0.67'. Though the ratio should not be more than one.

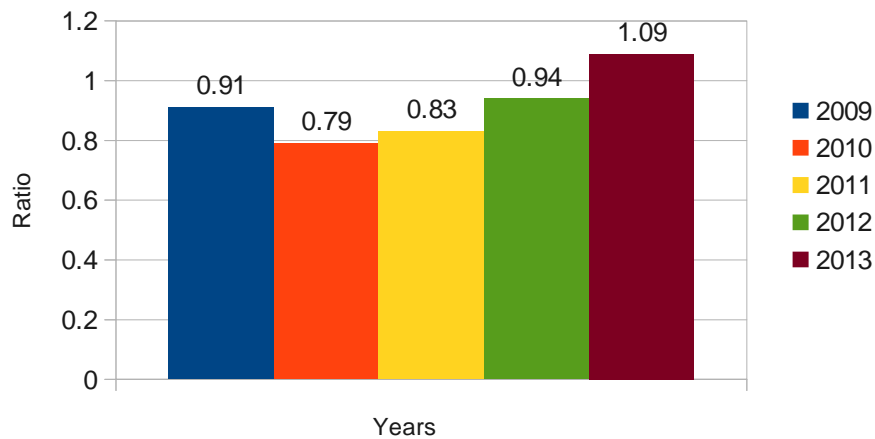
**TABLE 4**

Years	2009	2010	2011	2012	2013
Fixed asset ratios trend.	0.91	0.79	0.83	0.94	1.09

Sources: Computed data from Annual Reports

**FIGURE 3**

**Fixed Assets Ratio**



**INFERENCE**

In the year 2013 the ration was more than one which indicates that the fixed assets are purchased with short term funds which are not a prudent policy in the business.

The year 2009, 2010, 2011 and 2012 the ration is less than one which indicates that a portion of working capital has been financed by long term funds.

**DEBT EQUITY RATIO ANALYSIS**

The company would be able equate total debt to total assets since total capital represents total assets. Which could enable Mumias to measures a portion of business assets financed by creditors. The ideal ration is '1'.

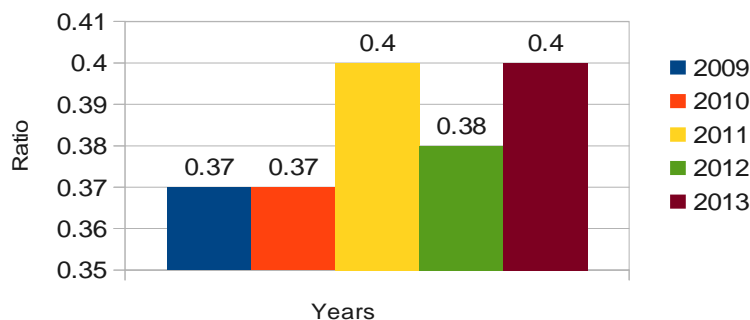
**TABLE 5**

Years	2009	2010	2011	2012	2013
Debt equity ratios trend.	0.37	0.37	0.40	0.38	0.40

Sources: Computed data from Annual Reports

**FIGURE 4**

**Debt Equity Ratio**



**INFERENCE**

In the long run, the ration is below the ideal which indicates that Mumias Sugar company's management considered favourable since greater claim of shareholders over the assets of the company than those of the creditors. Thus it provides greater margin of safety to creditors in extending credit, which is disadvantageous to shareholders as they get lesser dividend.

**CAPITAL GEARING RATIO ANALYSIS**

The ratio could be employed by company to show the proportion of various items of long term finance employed in Mumias Sugar Company's business. Which indicates proportion between owners' fund and non owners funds (leverage).

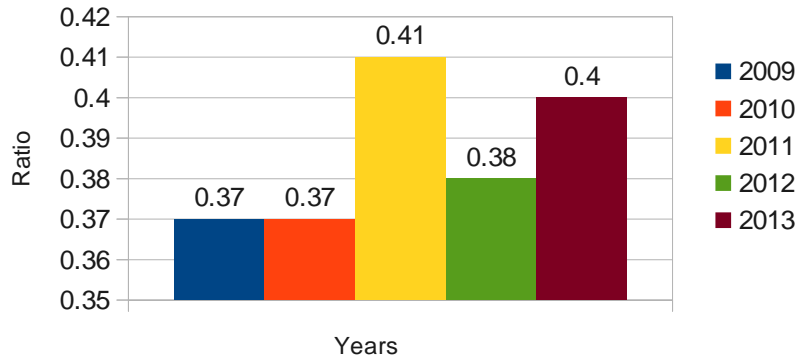
**TABLE 6**

Years	2009	2010	2011	2012	2013
Capital gearing ratios trend.	0.37	0.37	0.41	0.38	0.40

Sources: Computed data from Annual Reports

**FIGURE 5**

**Capital Gearing ratio**



**INFERENCE**

It can be inferred that throughout the five years the company discloses a low gearing ratio which indicates that the company is trading on thick equity. The equity shareholders funds are more and the capital is said to be low geared.

**CONCLUSIONS**

- ➔ The company's short term solvency was fairly good even though the recent years i.e 2012 and 2013 showed departure from the accepted standard to be maintained in an organization. It thus reveals that its liquidity was doubtful for it was not in position to meet its current liabilities as and when they are due. It can be presumed that they were met through long term loans because much of current assets are used in financing non current assets of the company.
- ➔ The long-term solvency of the company was favourable as there was greater claim of shareholders over the assets of the company than those of the creditors on the company.
- ➔ There was no trading on equity as the company traded on thick equity alone which led to low gearing ratio on the owners of the company which is disadvantageous on earnings of the company.

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## ANNEXURE

TABLE 7: COMPARATIVE BALANCE SHEET OF MUMIAS SUGAR COMPANY LTD FOR PERIOD OF FIVE YEARS I.E 2009 TO 2013

Particulars	2013 ('000)	2012 ('000)	2011 ('000)	2010 ('000)	2009 ('000)
<b>Non current assets.</b>					
Property, plant and equipment.	19,615,082	19,810,560	16,415,740	11,585,953	12,098,452
Intangible assets.	315,676	206,603	156,732	142,879	186,203
Non current receivables.	157,695	150,090	92,385	98,393	79,128
<b>Total Non C.A</b>	<b>20,088,453</b>	<b>20,167,253</b>	<b>16,664,857</b>	<b>11,827,225</b>	<b>12,363,783</b>
<b>Current assets.</b>					
Inventories	2,463,064	1,676,088	1,191,114	955,078	796,096
Biological assets.	219,378	191,093	210,615	179,375	189,501
Trade and other receivables.	3,765,866	4,584,048	3,863,595	3,327,244	3,262,935
Taxation recoverable.	183,102	200,214	250,109	401,301	396,032
Collateral deposit.	301,925	294,817	314,524	286,709	272,892
Short term deposits.	-	51,797	14,345	820,376	-
Quoted investments – at fair value.	44,106	35,240	25,267	-	-
Cash and bank balance.	70,923	138,063	642,090	525,751	182,381
<b>Total C.A</b>	<b>7,048,364</b>	<b>7,171,360</b>	<b>6,511,659</b>	<b>6,495,834</b>	<b>5,099,837</b>
Non current assets held for sale.	11,576	61,500	-	11,051	12,095
<b>Net C.A</b>	<b>7,059,940</b>	<b>7,232,860</b>	<b>6,511,659</b>	<b>6,506,885</b>	<b>5,111,932</b>
<b>Total assets.</b>	<b>27,148,393</b>	<b>27,400,113</b>	<b>23,176,516</b>	<b>18,334,110</b>	<b>17,475,715</b>
<b>Equity and liabilities.</b>					
<b>Equity.</b>					
Share capital.	3,060,000	3,060,000	3,060,000	3,060,000	3,060,000
Revaluation surplus.	3,173,432	3,350,880	3,552,456	1,535,846	1,687,251
Retained earnings.	7,055,538	9,312,806	7,863,551	6,404,006	5,292,218
<b>Shareholders equity.</b>	<b>13,288,970</b>	<b>15,723,686</b>	<b>14,476,007</b>	<b>10,999,852</b>	<b>10,039,469</b>
<b>Non current liability.</b>					
Deferred income taxation liability	2,443,472	3,027,494	3,327,449	1,846,201	1,238,710
Provision for service gratuity.	10,464	2,747	3,735	19,800	16,597
Deferred grant income.	15,379	-	11,800	25,760	37,786
Long term borrowing.	2,981,335	2,925,531	2,395,834	2,192,476	2,382,814
<b>Total Non C.L</b>	<b>5,450,650</b>	<b>5,955,772</b>	<b>5,738,818</b>	<b>4,084,237</b>	<b>3,675,907</b>
<b>Current liabilities.</b>					
Borrowings.	3,058,448	2,463,448	610,028	337,304	897,397
Trade and other payables.	4,844,672	2,928,017	2,024,399	2,567,492	2,509,110
Provision for service gratuity.	5,652	1,201	10,482	6,474	4,454
Provision for staff leave pay.	43,626	28,552	33,822	29,478	28,157
Unclaimed dividends.	456,375	299,437	282,960	309,273	321,221
<b>Total C.L</b>	<b>8,408,773</b>	<b>5,720,655</b>	<b>2,961,691</b>	<b>3,250,021</b>	<b>3,760,339</b>
<b>Total equity and liabilities.</b>	<b>27,148,393</b>	<b>27,400,113</b>	<b>23,176,516</b>	<b>18,334,110</b>	<b>17,475,715</b>

Source: Published company's financial reports

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