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Preparing Polish Micro-Enterprises for the Loss of Liquidity

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Abstract:

Purpose: *The main objective of the study was to identify, analyse and diagnose the level of liquidity preparedness of Polish micro-entrepreneurs and to determine the structure of liquidity buffers in terms of assets used.*
Design/Methodology/Approach: *The study used literature analysis and critique, a diagnostic survey and statistical methods. The study was based on a questionnaire survey of a randomly selected sample of 105 micro-entrepreneurs, with the qualification of respondents being (a) sole proprietors, (b) sole proprietors providing services in a B2B relationship and (c) microcompanies employing fewer than 10 people. A CAWI survey was used.*
Findings: *The results of the survey show that sole proprietors (SPUs) are more vulnerable to a lack of financial security than entrepreneurs with other forms of business - in fact, 25% of the surveyed SPUs have no financial security at all. The high proportion of SEMs with minimal provisions (up to PLN 10 000) suggests that they are particularly vulnerable to financial problems in a crisis. B2B entrepreneurs providing B2B services as JDGs have lower percentages of no financial security (18.75%) and minimal reserves (6.3%), suggesting they are better prepared for financial distress. Micro companies have the lowest percentage of financial insecurity (19.04%) and a low percentage of provisions of up to PLN 10,000 (9.5%), suggesting better financial management. In general, a larger company organisational structure correlates with better financial security. JDGs are the most exposed to financial risk, while micro companies seem best prepared for unforeseen events. The results suggest that different business forms have different financial management strategies. JDGs prefer liquidity and security, micro-companies stability, and B2Bs as JDGs show more diversification of investments.*

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Practical Implications: *The practical business implications mainly relate to the possibility for entrepreneurs to use the results to learn about different options for securing themselves against liquidity loss and to become aware of the need for such security. The implications can also be used by training companies providing services to entrepreneurs to expand their offerings to include training in the use of various financial instruments and assets for corporate financial security. Originality/Value: It was found that those running JDGs do not have sufficient security against liquidity loss in contrast to those running micro companies, who have more resources in this regard.*

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Keywords: *Financial management, corporate financial analysis, micro-entrepreneurs.*

JEL Classification: *G35, G39, M10.*

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1. Introduction

Over the past twenty-five years, European political and socio-economic transformations have been densely intertwined with globalisation processes, advances in information civilisation and the development of the knowledge economy (Lesniak-Moczuk, 2016, p. 105). The modern economy is characterised by dynamic development and constant change. This in turn forces organisations to modify their existing operating principles in order to keep up with trends and remain competitive. The adaptation of enterprises to new conditions requires them to redefine the ways in which they manage their resources.

It is becoming crucial to make efficient use of human, financial and physical capital in order to meet the challenges posed by the market. However, simply adapting to current trends is not enough. In order to maintain a leadership position in the industry, companies must stay ahead of change and constantly ask themselves questions about the future. Seeking answers to these questions requires a creative approach, openness to new solutions and a willingness to take risks.

Aspects of corporate insolvency are considered and analysed by practitioners of financial institutions, academics, but also machine learnin. It is worth noting that machine learning enables the development of bankruptcy prediction models (Lombardo *et al.*, 2022). Identifying the factors (variables) that influence the causes of corporate bankruptcy is a challenge as complex as the issue of bankruptcy itself.

In most models, variables characterising the financial situation of companies are proposed because of their ease of access.

However, in some cases, especially in analyses of specific industries or sectors of the economy, financial variables may prove insufficient to fully describe the risk of enterprises' functioning, therefore it is worth reaching for non-financial variables as well, such as macroeconomic indicators, labour market indicators, stock market data or indicators related to intellectual capital (Andreasik and Salej, 2005, p. 47).

Running a business increasingly requires the use of a variety of information, advisory and financial services. Entrepreneurs often face numerous obstacles caused by complicated legal regulations and formalised office structures. Business environment institutions work to break down these barriers and improve cooperation with entrepreneurs and potential investors (Gródek-Szostak, Kapuścińska, Kołodziej and Kotnis, 2020, p. 1467; Auzina *et al.*, 2023).

Micro-enterprises play a key role in the functioning of the Polish economy, being its essential pillar. Their importance stems from generating employment, stimulating economic growth and making a significant contribution to innovation. Nevertheless, many micro-enterprises constantly face liquidity challenges, which may threaten their stability and further development. This publication, based on research, provides a preliminary analysis of whether Polish microenterprises are prepared for a potential loss of liquidity and is a contribution to further in-depth research in this area.

The analysis of the collected survey data allows important conclusions to be drawn on the level of micro-entrepreneurs' awareness of the risks of losing financial liquidity and their preparation for possible financial problems. For the functioning of the economy, it is very important for persons running micro-enterprises to be aware of the consequences of losing financial liquidity. Not being aware of these consequences may lead to a lack of adequate preventive measures and increase the risk of serious problems.

The liquidity management strategies applied by microenterprises may not be sufficient. The lack of (or too few) tested plans to deal with sudden drops in revenues, increases in liabilities or the occurrence of other factors destabilising financial liquidity may result not only in the mass disappearance of micro enterprises from the market, but also in destabilisation of the entire economy.

2. Characteristics of Micro-Enterprises and Research Thesis

Under Polish law, a company is considered a micro-entrepreneur if it fulfils all of the following conditions: a) in the last two financial years the entity did not employ more than 10 employees, b) the annual net turnover from the sale of goods, services and financial operations is not higher than two million euros (converted into Polish zlotys), c) the total assets of the final balance sheet do not exceed two million euros (converted into Polish zlotys) (Law on Entrepreneurs, 2018).

This designation of a group of businesses by the legislator has resulted in a broad segment of the Polish economy, especially in the form of small family businesses and sole proprietorships, being able to enjoy certain business conveniences, such as simplified accounting or lower contributions paid to the Social Insurance Institution.

A change in the status of a micro-entrepreneur may occur as a result of a modification of the actual business situation. The quota limits for the turnover and assets of micro-enterprises are set on the basis of the average exchange rate on the last day of the previous year, which means that these values may change depending on the exchange rate.

If a company exceeds the average annual employment limit for two consecutive financial years, it will automatically be transferred to the small taxpayer category, even if its turnover does not exceed €2 million. This will result in the need to apply different accounting rules with the tax office (Entrepreneurs' Law, 2018).

Micro-entrepreneurs, by virtue of the smaller scale of their business activities, are particularly vulnerable to difficulties in financing their business activities. It is for this reason that securing liquidity is one of the key factors in guaranteeing survival in the market - even in difficult and unpredictable circumstances.

A company's financial liquidity plays a key role in ensuring the continuity of its operations on the market, as it enables timely payment of its current liabilities to various entities: counterparties, credit institutions, employees, social security and the state budget. The loss of financial liquidity translates into a decrease in the financial results of enterprises, mainly due to an increase in operating and financial costs and a decrease in sales (Czainska *et al.,* 2021).

Deterioration of financial results leads to the loss of the company’s ability to service existing debts and to incur new ones. Loss of financial liquidity is the first symptom of company bankruptcy (Dawidziuk, 2019). An enterprise is considered to be liquid if it has enough financial resources to cover its financial liabilities in a timely manner with minimal cost.

The first essential ingredient of liquidity is the time it takes to convert an asset into cash or to pay a current liability and the quicker that an asset can be converted into cash, the more liquid it is.

A second ingredient of liquidity is amount and an enterprise must have enough liquid resources to cover its financial liabilities coming due. Cost is the third ingredient and an asset is liquid if it can be quickly converted into cash with little cost (Maness and Zietlow, 2005, p. 31).

Liquidity is a function of current assets and current liabilities and their composition. A company's level of liquidity depends upon the amount of the company's cash, the amount of other assets that can be quickly converted to cash, whether the company is making or losing money, the amount of obligations that will require repayment in the near future and the ability of the company to raise more cash by issuing securities or borrowing money (Chambers and Lacey, 2011, p. 489).

The level of liquidity usually depends on the industry in which the company operates. If a company has a low level of liquidity, it may have problems paying its debts on time, but when it is over-liquid, working capital is not optimally used, leading to a decrease in its profitability (Nesterowicz, Nakonieczny, and Nesterowicz, 2022; Thalassinos and Berezkinova, 2013).

The greatest challenge for entrepreneurs is to maintain financial liquidity not only at a high, but also at an optimal level. Kontuš and Mihanović (2019) believe that liquidity management should consist of defining the independent variables that determine net savings by reducing the amount of liquid assets and, secondly, modelling the relationship between these variables to achieve net savings by reducing liquid assets and investing surplus cash.

Costs and benefits for holding liquid assets have to be carefully weighed against the opportunity costs for holding more productive but less liquid assets. Optimal amount of liquidity is determined by a trade-offs between the low return earned on liquid assets and the benefit of minimising the need for external finance (Kim, Mauer, and Sherman, 1998, p. 335).

The issue of maintaining financial liquidity is important for both micro, small, medium, and large companies operating in Poland. It is particularly important for micro and small enterprises, which, lacking financial support, are most exposed to the risk of losing liquidity (Chmielak, Ejsmont, Zabielska, 2018, p. 91).

Effective liquidity management involves a number of decisions, including the purchase of materials and raw materials, the sale of goods and finished goods, as well as the development of credit policy towards customers. In addition, decisions regarding short-term financing are important.

All these actions result from the adopted strategies regarding investment in current assets and their financing, which is necessary to maintain the financial stability of the enterprise (Zawadzka, 2009, p. 603). Maintaining financial liquidity, with dynamic market changes and current customer preferences, is also strongly influenced by the need to innovate within the enterprise.

Among the most important are: information about the successful implementation of innovations by competitors, a decrease in the efficiency of existing solutions in areas such as production, marketing, logistics, etc., the emergence of a new idea or concept or the possibility to implement previously unavailable innovations (Oksanych , 2020, p. 176).

Liquidity management also requires the monitoring of cash flow so that the entrepreneur can be sure that he or she always has sufficient funds to cover obligations. Companies often have to choose between paying their liabilities quickly and maintaining adequate cash levels for investment.

Liquidity allows businesses to take advantage of market opportunities as they arise and to minimise the risks associated with sudden expenditure. As a result, skilful liquidity management contributes to the confidence of business partners and financial institutions, which can bring additional benefits in the form of better credit terms and longer payment terms.

Entrepreneurs are a group of people who often consider using so-called tax optimisation, which is not insignificant for the financial security of the company. Tax optimisation involves the use of available legal tools to minimise the tax burden. The ability to use tax optimisation is often referred to as tax intelligence, which means the application of tax laws to reduce taxes in a lawful manner (Nenca and Zawadzka, 2014, p. 25).

The way in which a micro-enterprise is managed is fundamentally different from the management of a medium or large business entity, especially in terms of the organisational structure, which has a fundamental influence on decisions and the ways in which they are implemented. A micro-enterprise is usually characterised by a simple, flat organisational structure in which the owner has multiple functions at the same time - responsible for management, finance, marketing and operations. Communication is direct and hierarchy is minimal.

In contrast, medium and large companies have more complex, multi-level organisational structures with specialised departments such as HR, marketing, finance, IT and operations. Each department is managed by managers and communication is often through formal channels.

In this type of entity, modern management and marketing concepts are often used, such as holistic marketing, which is the combination of many areas of the company (Ruta, 2023, p. 247). Microenterprises, on the other hand, are usually managed by owners who act as managers. The object of management in such enterprises is a team of employees or a single employee.

Between the team and the manager there are relationships of a business and informal nature. The former relationships enable the manager to plan and organise the work of subordinates, give instructions, control performance and apply sanctions. The effectiveness of the manager then depends on his formal authority and technical competence (Więcek-Janka, 2006, p. 116).

This is why the personality traits of the individual business entrepreneurs are so important in the case of micro-enterprises. One of the characteristic features of micro-enterprises is the dominance of the personality of the entrepreneur, who is both owner and manager of the company.

Personality, understood as a unique way of thinking and feeling that remains constant throughout life, is different from character and temperament. Research on personality, which 5 has been carried out for many years, aims to describe it and to predict future human behaviour. It is therefore interesting to consider whether the micro-entrepreneur's innovativeness might be one such predictable behaviour. If so, it is worth considering which traits or aspects of his or her personality may be conducive to innovation and a correct understanding of the processes taking place in the market environment (Zastępowski, 2023, p. 41).

The study on which this publication is based verified the following research areas and hypotheses:

H1: Scale of liquidity provision for Polish micro-entrepreneurs.
H2: The structure of financial collateral (in terms of the choice of assets that are such collateral) in the event of liquidity loss of Polish micro-entrepreneurs.

The article focuses on two key aspects of financial hedging against unexpected liquidity loss. Hypothesis H1 suggests that the level of this collateral may be low or unsatisfactory. This is an important issue as a lack of adequate collateral can lead to serious consequences for businesses and individuals. Hypothesis H2 investigated the structure of financial collateral, with a particular focus on the choice of assets used as collateral. This is an important aspect as the diversity of assets can affect the effectiveness of the collateral and its resilience to volatile market conditions.

The results of the research can also be a valuable resource for financial institutions, regulators and risk management experts, allowing them to better adapt to changing market conditions. Access to such detailed analysis can enable a quicker response to potential risks and a better use of available tools to prevent financial crises.

Research on financial hedging is crucial not only for the current economic situation, but also for the long-term prospects for companies and business units. It is possible that the results of this research will contribute to the development of new tools and methods of financial risk analysis that can be applied by companies and financial institutions.

In addition, understanding the mechanisms of financial hedging has the potential to contribute to better risk protection and stimulate economic growth. As a result, this research can shape a more stable and resilient financial system at the local, national and global levels. This will allow for more effective risk management, contributing to greater stability and security for the economy as a whole.

3. Materials and Methods

3.1 Sample and Survey Data

The aim of the survey was to analyse the habits and actions of entrepreneurs in terms of liquidity protection. A quantitative and qualitative online CAWI survey was carried out using an internet panel in the Republic of Poland, based on a questionnaire presented to 105 individuals with the status of micro-entrepreneurs (according to the legal status in force in the Republic of Poland).

Of the respondents, 8.8% declared that they also had an employment contract, which may indicate the diversity of their sources of income. In addition, 1.5% of respondents admitted to running an additional business on the basis of a contract of mandate, which suggests that some entrepreneurs may engage in a variety of forms of employment.

Another interesting result is that 18.8% of the respondents provide work as part of a sole proprietorship as a B2B collaboration, which may indicate developed business relationships in this group of entrepreneurs. In addition, 19% of respondents operate micro companies employing fewer than 10 people, suggesting that the size of employment in these companies varies, with some operating as sole proprietorships.

3.2 Definitions of Measures and Variables

The decision was taken to measure financial security against sudden liquidity loss based on the indicated data by the respondents using the CAWI method, which is helpful in carrying out many scientific quantitative and qualitative studies conducted in remote communication via an online panel (Verma and Rastogi, 2023, p. 56).

The responses provided by the respondents were obtained by asking questions about the level of financial security in case of sudden liquidity loss and the structure of financial security (in terms of the choice of assets that are such security) in case of unexpected liquidity loss. Micro-entrepreneurs were defined on the basis of the legal regulations contained in the Act of 6 March 2018. - Entrepreneurs' Law (Journal of Laws 2018, item 646).

The responses signified the declaration of individual entrepreneurs with regard to the possession of cash or other assets designated by the business operators as means of securing against the loss of financial liquidity, understood as the loss of the ability to pay current liabilities on time and to make necessary purchases, which results from structural and potential liquidity.

In this context, a company's ability to pay depends on the one hand, on its ability to convert its assets into cash, which is used to settle current liabilities or make purchases on the market (Kuciński, 2022, p. 182).

3.3 Data Analysis

The study aimed to verify the research hypothesis formulated on the basis of the supposition that Polish micro-enterprises are insufficiently prepared for the loss of financial liquidity. A variety of methods were used to verify this hypothesis, including a literature review, a survey method and a statistical research method.

Quantitative and qualitative research was conducted using a self-administered questionnaire, which was presented to qualified respondents using the CAWI method. The results of the survey can provide valuable insights into corrective actions and strategies to improve liquidity.

Results in area H1 (scale of financial security against loss of liquidity of Polish micro-entrepreneurs), the following verification was made. An attempt was made to determine how high the level of financial security against loss of liquidity is by asking qualified respondents whether their company has funds dedicated solely to ensure the functioning of the company in the event of unforeseen events (such as the effects of pandemics, natural disasters, the effects of armed conflicts, etc.) (Table 1).

4. Research Results

In area H1 (scale of financial security against loss of liquidity of Polish micro-entrepreneurs), the following verification was made. An attempt was made to determine how high the level of financial security against loss of liquidity is by asking qualified respondents whether their company has funds dedicated solely to ensure the functioning of the company in the event of unforeseen events (such as the effects of pandemics, natural disasters, the effects of armed conflicts, etc.) (Table 1).

Table 1. *Responses of qualified respondents to the question of whether their company has resources dedicated solely to ensuring the operation of the company in the event of unforeseen events (such as the effects of pandemics, natural disasters, the effects of armed conflicts, etc.), with an indication of the scale of this provision in each of the ranges shown in the table.*

To what extent does your company have resources that are solely dedicated to safeguarding the operation of the company during unforeseen events (e.g. effects of pandemics, natural disasters, effects of armed conflicts, etc.)?	Sole trader	Provision of services in a company as a B2B contract as a JDG	Micro company with less than 10 employees
	% of n	% of n	% of n
I do not have such resources	25,00	18,75	19,04
I have up to PLN 10 000	29,4	6,3	9,5
I have between PLN 10 000 and 20 000	10,3	37,5	14,3
I have between PLN 20 000 and 50 000	17,6	12,5	28,6
I have between 50 000 and 100 000 PLN	4,4	18,8	14,3

I have between PLN 100 000 and 200 000	2,9	6,3	0
I have more than PLN 200 000 for such a purpose	2,9	0	0
I don't know/difficult to say	7,4	0	14,3
Total	100	100	100

Source: *Authors' own research.*

Analysing the results of the survey of entrepreneurs in terms of their financial security, several important trends can be observed depending on the type of business. Well, 25% of the surveyed group of entrepreneurs in the structure of a sole proprietorship (JDG) do not have any means to secure the operation of the company in emergency situations.

This is a rather high percentage, which indicates a high risk for this group in the event of unforeseen events. In contrast, 29.4% have financial security of up to PLN 10,000, suggesting that most entrepreneurs in this group have minimal financial reserves. For the group of those providing services as a B2B contract as a JDG, lack of financial security was indicated by only 18.75%, which is a lower percentage compared to JDG.

Funds of up to PLN 10,000 are held by 6.3% of entrepreneurs in this group, which is the lowest percentage compared to other business types. In the case of micro companies, employing less than 10 persons, lack of financial security concerns 19.04% of the respondents, which is the lowest percentage in comparison with the other groups. Funds of up to PLN 10,000 are at the disposal of 9.5% of entrepreneurs in this group, which is also a relatively low percentage.

As Andrzej Kuciński points out (on the example of Kania SA), having funds as security against the loss of financial liquidity is an essential element of management, which can protect against entering a state of crisis management consisting of defence against negative cash flows from operating activities.

In order to continue business operations in such conditions, the company must make up the missing funds through financing activities, taking out loans, borrowing and issuing bonds in the case of larger companies. Increasing debt combined with negative operating cash flows can - and in many cases has - led to a situation where the company's future operations are dependent on further bank financing, which significantly increases the risk of liquidity loss (Kuciński, 2021, p. 89) (Table 2).

Table 2. *Qualified respondents' responses to the question on the structure of their financial hedge (in terms of the choice of assets that are such a hedge) in the event of liquidity loss.*

Are the funds intended only to secure the operation of the company during unforeseen events referred to in the previous question:	Sole trader	Provision of services in a company as a B2B contract as a JDG	Micro company with less than 10 employees
	% of n	% of n	% of n
...are deposited in the form of cash	25,5	23,1	5,9
...are held in a bank account	52,9	15,4	35,3
...are placed on bank deposits	27,5	38,5	35,3
...are placed in bonds of the Polish Treasury	7,8	7,7	23,5
...are placed in shares of listed companies	3,9	7,7	0,0
...are located in cryptocurrencies	7,8	7,7	5,9
...are located in raw materials	7,8	15,4	5,9

Source: *Authors' own research.*

Most funds are held in cash by sole traders (25.5%) and B2B service providers as JDGs (23.1%). For micro companies, only 5.9% of funds are held in cash. This can be explained by the greater emphasis on liquidity and the availability of funds 'on hand' in sole proprietorships and B2B businesses. Bank accounts are the most popular form of deposit among JDGs (52.9%), suggesting a preference for easy access to money with some level of security. Micro-companies (35.3%) also use this form, although to a lesser extent than JDGs.

B2B service providers as JDGs place only 15.4% of funds here, which may indicate greater diversification or other priorities in financial management. Bank deposits are a popular option for both B2B service providers as JDG (38.5%) and micro companies (35.3%). JDGs use this form of deposit in 27.5% of cases. The high percentage of deposits may indicate a preference for financial instruments that are safe, but slightly more profitable than bank accounts.

Treasury bonds are most often chosen by micro companies (23.5%), which may be due to their stability and safety. In the case of JDGs and B2B service providers as JDGs, only around 7.8% and 7.7% of funds, respectively, are invested in bonds, suggesting less interest in this type of instrument in these groups. Investments in shares of listed companies are the least popular.

B2B service providers as JDGs show the most interest in them (7.7%), while only 3.9% of JDGs opt for equities. Micro-companies do not invest in equities at all, which may be due to risk aversion. Investments in cryptocurrencies are moderately popular among both JDGs (7.8%) and B2B service providers as JDGs (7.7%). Micro-companies also show some interest in cryptocurrencies (5.9%). This may suggest some confidence in these assets as a form of diversification.

Investments in commodities are most popular among B2B service providers as JDGs (15.4%), while JDGs and micro-companies show similar lower levels of interest (7.8% and 5.9%).

5. Conclusions

The survey results show that sole traders (JDG) are more likely to lack financial security compared to other forms of business. The lack of financial security in this group was indicated 9 by 25% of the respondents, which is a significant percentage. Also, the high percentage of entrepreneurs with minimal financial reserves (up to PLN 10,000) suggests that JDGs may be particularly vulnerable to financial problems in crisis situations.

It is interesting to note that traders providing B2B services as JDGs show a lower percentage of financial insecurity (18.75%) and the lowest percentage of provisions of up to PLN 10,000 (6.3%). This may suggest that B2B entrepreneurs are more risk-aware and better prepared for possible financial difficulties.

In the case of micro companies, the results show the lowest percentage of no financial security (19.04%) and a low percentage of provisions up to PLN 10,000 (9.5%). This is a positive sign that may indicate better financial management in small companies compared to JDG. The sole trader is the most exposed to financial risk, with a high proportion of entrepreneurs having no collateral.

Entrepreneurs providing services as a B2B contract as a JDG are more financially secure, with a higher proportion having funds between PLN 10,000 and PLN 20,000. Micro-commercials exhibit the greatest financial stability relative to the other groups, with a relatively low proportion of entrepreneurs having no financial security and a high proportion having provisions in the PLN 20,000 to 50,000 range. Overall, the results suggest that the larger the organisational structure of the business, the better the financial security.

One-person businesses are the most susceptible to financial risk, while micro-companies seem best prepared for unforeseen events. The results of the survey indicate that different forms of business have different priorities and strategies for managing financial resources.

JDGs prefer liquidity and security, micro companies lean towards stable financial instruments, and B2B service providers as JDGs show more diversification in their investments. These differences may be due to the different approaches to risk, liquidity, and capital management strategies of each business type.

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