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BUSINESS CONSULTANT

Good solutions for your business!

Helping You Out-Think, Out-Perform and
Out-Earn the Competition-Risk Free & Guaranteed!

Financial Management Assessment

Take Your Fiscal Temperature with Financial Ratios

Ratio analysis is an excellent method for determining the overall financial condition of your small business. It puts the information from a financial statement into perspective, helping to spot financial patterns that may threaten the health of your company.

Ratios are also very useful for making comparisons between your business and other businesses in your industry. For example, comparing ratios can indicate whether a business is holding too much inventory or collecting receivable too slowly. This comparison provides a window into ways in which your business can improve its operations.

This financial ratios tool can be used to calculate 11 key financial ratios for your small business. When using the tool, keep a copy of your company's balance sheet nearby so you have the correct figures to plug in.

Getting the Most Out of Ratios

Ratios are most commonly used for trend analysis - tracking your business's financial figures over a period of time. Being able to identify trends in a balance sheet will help you manage cash flow more effectively and ultimately enhance the bottom line. Ratios can also be used to see how your company measures up to others in your industry or region. Use the tips below to get the most out of your ratio analysis:

Create a baseline

In order to identify a trend in your financial situation; you need to create a baseline against which to compare current ratios. This will require an analysis of your past balance sheets. Contact your financial advisor for assistance in creating these baselines.

Compare yourself to others in your industry

Ratios are also useful to see how your business stacks up against similar companies

in your industry. Trade associations often offer this kind of data to members. There are also a number of directories that list common ratios by industry, including the following:

- [Dun & Bradstreet](#) publishes key business ratios in Dun's Review as well as in its annual "Cost of Doing Business."
- The Almanac of Business and Industrial Financial Ratios, from [Aspen Publishers](#) uses IRS data to provide ratios for nearly 180 SIC classifications.
- [The Risk Management Association](#), a national association of bank loan and credit providers (formerly called Robert Morris Associates), publishes annual statement studies containing ratios for more than 225 industries.

Run analyses regularly

Ratio analysis becomes more valuable the more you do it. Scrutinized on a month-to-month or year-to-year basis, these numbers can paint an accurate financial picture of a business' financial performance. By making a commitment to running these numbers regularly, you will be able to identify financial trends early on, allowing you to take appropriate action.

Understand the different ratios. There are different types of financial ratios for different purposes. In general, they tend to fall into three categories:

- **Liquidity ratios:** As the name suggests, these help measure how liquid a business is. They are commonly used by bankers and suppliers to measure how creditworthy you are. You can also use them to help uncover potential threats to your financial position. Examples of liquidity ratios are the [current ratio](#) and the [quick \(acid test\) ratio](#).
- **Efficiency ratios:** These tell you about cash flow, inventory efficiency, and how quickly your products or services sell. For example, you can judge how well collections policies are working by analyzing your company's receivables [turnover ratio](#) or your [average collections period](#).
- **Profitability ratios:** Ratios such as [return on sales](#) help determine if you are maximizing the bottom line. It is most common to analyze these ratios in light of the performance of industry peers.

Use comparisons carefully

There are a number of things to take into account when running ratio comparisons. For example, watch out for seasonal issues - comparing fourth quarter performance to third quarter performance might not be as accurate an appraisal as comparing comparable quarters year-to-year. Similarly, if you are comparing your company's performance to others in the industry, be sure to consider variable factors such as location, size of operations, and intensity of competition. If you are new to using financial ratios, review this article to learn ratio analysis basics and gain access to resources for finding ratio baselines.

Apply the Ratios to Your Small Business

Get in the Hot Seat

Current Ratio

What it is:

The current ratio is the standard measure of any business' financial health. It will tell you whether your business is able to meet its current obligations by measuring if it has enough assets to cover its liabilities. The standard current ratio for a healthy business is two, meaning it has twice as many assets as liabilities.

When to use it:

The current ratio should be part of your business' basic financial planning, meaning it should be tracked monthly or quarterly. By keeping a close eye on this figure, you will recognize if it begins to get out of line. This will allow you to take early action to prevent your business from ending up in a difficult position.

The formula:

Current assets divided by current liabilities.

Calculate your current ratio:

Current assets \$.00

Current liabilities \$.00

Your current ratio

Quick Ratio

What it is:

Like the current ratio, the quick ratio (also sometimes called the acid test ratio) measures a business' liquidity. However, many financial planners consider it a tougher measure than the current ratio because it excludes inventories when counting assets. It calculates a business' liquid assets in relation to its liabilities. The higher the ratio is, the higher your business' level of liquidity, which usually corresponds to its financial health. The optimal quick ratio is 1 or higher.

When to use it:

This is an important planning tool, especially for businesses that can tie up a lot of assets in inventory. By tracking it monthly, you can keep an eye out for negative trends that could hamper your business' ability to meet its obligations. You can also use the quick ratio to evaluate the financial health of potential customers, since it also indicates whether a business can pay off its

debts quickly. A firm with a low quick ratio may be more likely to delay payments because its assets are tied up elsewhere.

The formula:

(Current assets less inventories) divided by current liabilities.

Calculate your quick ratio:

Current assets \$.00
Inventories \$.00
Current liabilities \$.00
Your quick ratio

Inventory Turnover Ratio

What it is:

This ratio tells how often a business' inventory turns over during the course of the year. Because inventories are the least liquid form of asset, a high inventory turnover ratio is generally positive. On the other hand, an unusually high ratio compared to the average for your industry could mean a business is losing sales because of inadequate stock on hand.

When to use it:

If your business has significant assets tied up in inventory, tracking your turnover is critical to successful financial planning. If inventory is turning too slowly, it could indicate that it may be hampering your cash flow. Because this ratio judges annual inventory turns, it is usually conducted once a year.

The formula:

Cost of goods sold divided by the average value of inventory.

Calculate your turnover ratio:

Cost of goods sold \$.00
Average value of inventory \$.00
Your inventory turnover ratio

Receivables Turnover Ratio

What it is:

This number indicates how quickly customers are paying your business. The greater the number of times receivables turn over during the year, the shorter the time between sales and cash collection.

When to use it:

Receivables turnover is a good way to gauge the effectiveness of your company's payment terms. If this number is low compared to the industry average, it may mean your payment terms are too lenient or that you are not doing a good enough job on collections. By tracking this figure monthly or quarterly, using total credit sales instead of net sales, you can uncover any changes in collections trends. Use this ratio in conjunction with [average collections period](#).

The formula:

Net sales divided by receivables.

Calculate your receivables turnover ratio:

Net Sales \$.00
Receivables \$.00
Your receivables turnover ratio

Average Collections Period**What it is:**

This ratio will indicate how quickly your customers are paying their bills by revealing the average length of your collection period. Ideally, the average collections period will be less than your credit terms plus 15 days.

When to use it:

The speed at which bills are collected has a significant impact on a business' cash flow. Use this ratio to determine how long your company's money is being tied up in customer credit. If you allow different credit terms for different transactions – net plus 30 days for some customers, net plus 60 for others -calculate the average collection periods separately.

The formula:

Accounts receivable divided by (annual net credit sales divided by 365)

Calculate your average collections period:

Accounts receivable \$.00
Net credit sales \$.00
Your average collections period

Payables Turnover Ratio

What it is:

This number reveals how quickly your company pays its bills. The payables turnover ratio reveals how often payables turn over during the year. A high ratio means there is a relatively short time between purchase of goods and services and payment for them. A low ratio may be a sign that the company has chronic cash shortages.

When to use it:

Payables turnover trends can help a company assess its cash situation. Just as accounts receivable ratios can be used to judge a company's incoming cash situation, this figure can demonstrate how a business handles its outgoing payments.

The formula:

Cost of sales divided by trade payables.

Calculate your payables turnover ratio:

Cost of sales \$.00

Trade payables \$.00

Your Payables Turnover Ratio

Inventory to Net Working Capital

What it is:

This ratio tells how much of a company's funds are tied up in inventory. It is preferable to run your business with as little inventory as possible on hand, while not affecting potential sales opportunities

When to use it:

Keeping track of inventory levels is crucial to determining the financial health of your business. If this number is high compared to the average for your industry, it could mean your business is carrying too much inventory.

The formula:

Inventory divided by net working capital.

Calculate your inventory to net working capital

Inventory \$.00
Net working capital \$.00
Your inventory to net
working capital ratio

Debt to Equity Ratio

What it is:

This ratio indicates how much the company is leveraged (in debt) by comparing what is owed to what is owned. A high debt to equity ratio could indicate that the company may be over-leveraged, and should look for ways to reduce its debt.

When to use it:

Equity and debt are two key figures on a financial statement, and lenders or investors often use the relationship of these two figures to evaluate risk. The ratio of your business' equity to its long-term debt provides a window into how strong its finances are. Equity will include goods and property your business owns, plus any claims it has against other entities. Debts will include both current and long-term liabilities.

The formula:

Total liabilities divided by total equity.

Calculate your debt to equity ratio:

Total liabilities \$.00
Total equity \$.00
Your debt to equity ratio

Return on Assets (ROA) Ratio

What it is:

This number tells you how effective your business has been at putting its assets to work. The ROA is a test of capital utilization - how much profit (before interest and income tax) a business earned on the total capital used to make that profit. This ratio is most useful when compared with the interest rate paid on the company's debt. For example, if the ROA is 15 percent and the interest rate paid on its debt was 10 percent, the business's profit is 5 percentage points more than it paid in interest.

When to use it:

Return on assets is an indicator of how profitable a company is. Use this ratio annually to compare your business' performance to your industry's norms.

The formula:

Earnings before interest and taxes (EBIT) divided by net operating assets.

Calculate your ROA ratio:

EBIT \$.00

Net operating assets \$.00

Your ROA ratio

Gross Profit Margin Ratio

What it is:

The gross profit margin ratio indicates how efficiently a business is using its materials and labor in the production process. It shows the percentage of net sales remaining after subtracting cost of goods sold. A high gross profit margin indicates that a business can make a reasonable profit on sales, as long as it keeps overhead costs in control.

When to use it:

This figure answers the question "Am I pricing my goods or services properly?" A low margin - especially in relation to industry norms - could indicate you are under pricing. A high margin could indicate overpricing if business is slow and profits are weak.

The formula:

Gross Profit divided by Total Sales.

Calculate your gross profit margin:

Gross profit margin \$.00

Total sales \$.00

Your gross profit margin ratio

Return on Sales Ratio

What it is:

This ratio compares after tax profit to sales. It can help you determine if you are making enough of a return on your sales effort.

When to use it:

If your company is experiencing a cash flow crunch, it could be because its mark-up is not enough to cover expenses. Return on sales can help point this out, and allow you to adjust prices

for an adequate profit. Also, be sure to look for trends in this figure. If it appears to be dropping over time, it could be a signal that you will soon be experiencing financial problems.

The formula:

Net profit divided by sales.

Calculate your return on sales ratio:

Net profit \$.00

Sales \$.00

Your return on sales ratio

Your Choice Is!

Additional Financial Management Calculations

Financial Management

Break Even Calculator

Break Even Analysis is an expected component of most business plans, especially for Startups. This calculator shows how much revenue you need to cover both fixed and variable costs.

Cash Flow Calculator

This calculator shows you how B2B sales, carrying inventory and rapid growth can affect your business's money.

Investment Offering Calculator

Use this calculator to view both sides of the investment table. See what an investor gets and what a company gives up all in one easy tool.

Starting Costs Calculator

This calculator helps you evaluate how much capital you'll need to start your business.

Online Business

Conversion Rate Calculator

This calculator shows you what impact improving your website conversion rate has on your total online sales. Enter your visitors and total orders, and you can see what an increase in conversion can do.

E-Mail ROI Calculator

Use this calculator to determine the ROI (return on investment) of your e-mail campaign. You can test different scenarios to see the results.

Pay-Per-Click ROI Calculator

Use this calculator to determine the ROI (return on investment) for your pay-per click advertising campaigns.

Investing

Discounted Cash Flow

Analyze how much your cash is worth today vs. in the future.

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