LOUCAS

ADDING MORE TO YOUR BUSINESS

Using ratios to help measure performance

Ratio Analysis
Ratios are calculated from an organisation's financial statements and are an effective business tool in measuring its performance.

By comparing the ratios to those of the previous year it is possible to determine whether a business is doing better this year than last year.

It is also possible to compare ratios of one organisation against those of another in a similar industry, a practice known as **Benchmarking**. This helps identify areas in which one business is either under performing or indeed is out performing another. Undertaking ratio analysis and making comparisons to market leaders within your industry will help focus on areas which require attention.

It is important not to simply calculate as many ratios as possible, but to identify those most relevant to your business.

Ratio Categories
There are many different ratios that can be calculated and which can be grouped together into five main categories:

- Profitability
- Liquidity
- Operational
- Solvency
- Gearing

Different interpreters of the financial statements will be more interested in certain ratios than others. For example, lenders will be interested in Gearing ratios such as interest cover and debt to equity, whilst business owners are likely to concentrate on Profitability and Operational ratios.

Measuring Business Performance and Target Setting
By carefully selecting the most suitable ratios business owners and managers can use the results to gain a better understanding of how their organisation is performing. The same ratios can also be used to set future targets.

For example, a business may be experiencing cash flow problems. The business owner believes that his customers are taking too long to settle their accounts. By calculating their **debtors days** and recording the results, it will be possible not only to establish what the current position is, but also to set targets for the future. This may be to reduce the debtor days from thirty five to twenty five days. A reduction in debtor days will help ease cash flow and reduce the risk of bad debts.

An organisation should select a number of ratios which provide key information about its performance. These are known as **Key Results Indicators**. Whilst these will vary from business to business some of the most common are listed below:

- Gross Profit Margin
- Net Profit Margin
- Trading Overheads as percentage of Turnover
- Debtor & Creditor Days
- Current Ratio
- Debt to Equity
- Return on Capital Employed

INSIGHT:

It is important not to simply calculate as many ratios as possible, but to identify those most relevant to your business.

The calculated ratios should be recorded in a concise format and form part of the management information reports. The use of graphs will allow trends to be easily identified, avoiding the risk of getting lost in the numbers.

Further Information

As a firm, we are able to provide a wide range of services tailored to your particular industry. We believe by staying up to date with not only current but changing legislation and industry news we are better placed to help our clients and their businesses succeed.

If you would like to discuss any of the topics in this update or how Loucas can assist you please do not hesitate to contact us.