Using Ratios for Performance Analysis

Profitability ratio 1 (net profit / turnover) x 100%

Indicates how successful the enterprise is at turning sales into profits.

Profitability ratio 2 (net profit / total assets) x 100%

Indicates the return on capital employed and the possible rate of capital accumulation (of course those in control might decide to distribute some of the profit or give it away).

Current ratio current assets / current liabilities

Indicates the liquidity position. The higher the number the less cause for concern. Ideally looking for number of at least 2. A number near to or smaller than 1 indicates cash shortage.

Quick ratio 1 cash and debtors / current liabilities

Stiffer version of the current ratio, particularly used in difficult trading conditions to exclude stock and work in progress – the accumulation of which could be an embarrassment rather than a help. Ideally looking for number of at least 1. A number smaller than 1 indicates cash shortage.

Quick ratio 2 cash and debtors / average daily outflow

Gives a figure of how many days the company could survive without generating further income before the cash runs out.

Gearing ratio own funds / other peoples investment

Member's funds = net worth of the business – other people's investment. The bigger the number the stronger your control of the enterprise, and the stronger your position in getting more finance. The smaller the number the more outsiders can threaten stability of the enterprise by withdrawing their investment.

Turnover ratio purchases of stock or materials for period / average stock holding.

Indicates how fast stock is turning over. The higher the number the more efficiently stock has been managed (but be careful to balance against having the materials for the job and the stock to sell to customers).