Monitoring the Business: Ratios

There are 6 ratios students will need to know, they must be learned off by heart and applied to this topic. Please note there are:

3 Profitability Ratios, 2 Liquidity Ratios and 1 Gearing Ratio

Profitability- Want a high as possible

Gross Profit Margin (Gross Profit Percentage)

Gross Profit X 100 = %

Sales 1

Net Profit Margin (Net Profit Percentage)

Net Profit X 100 = %

Sales 1

Return on Investment/Return on Capital Employed (always compare to banks risk free interest rates)

(Capital Employed = Issued Share Capital + Retained Earnings+ Loans)

Net Profit X 100 = %

Capital Employed 1

Liquidity Ratios- Ability for a business to pay short term debts as they fall due

Current/ Working Capital Ratio

Current Assets: Current Liabilities =: (Ideal is 2:1)

Acid Test/ Quick Ratio

Current Assets- Closing Stock: Current Liabilities =: (Ideal is 1:1)

Gearing Ratio- Examines the types of long term finance or capital being used- A firm would want this to be as low as possible.

Debt Capital: Equity Capital=: (want below 50% or 1:1)

(Loans: Retained Earnings + Issued Share Capital + Reserves)