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Adapted from United Equipment Dealers Assn.'s Cost of Doing Business Study:

10 Key Financial & Operating Ratios

Financial and operating records, carefully maintained, provide dealers with the only sound measuring device for business performance. They help measure the ability of a business to generate profits and to meet claims against those profits. They also provide the basis for determining a business's strengths and weaknesses and may, through analysis, suggest how best to plan for profits and to maintain solvency. With this in mind, the following ratios have been developed from year-end income statements and balance sheets submitted by dealers in the current study. Thorough records will enable comparisons of these ratios that are valuable to the dealer.

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Current Ratio

Current Assets/Current Liabilities = Current Ratio

Figure by dividing Current Assets by Current Liabilities. This ratio compares the total of cash and the items which will be converted into cash with debts which must be paid soon. Thus, the ratio reflects ability to handle current debts. A ratio of two-to-one ($2 of Current Assets to each $1 of Current Liabilities) is considered satisfactory. When the ratio falls below this, creditors may scrutinize a dealer's operation more closely.

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Employee Studies

Sales per Employee vs Average Sales = Comparison of Employee Performance

Comparing your sales per employee in each category to the average is the first step in measuring employee efficiency. The next step is to compare your current year figures to previous years.

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Ownership Equity

Net Worth/Total Assets = Ownership Equity Ratio

Calculate by dividing Net Worth by Total Assets. Ownership Equity is shown on the "Total Net Worth (Equity)" line of the balance sheet. This ratio shows how much of the business is proprietor-owned. And, conversely, by subtracting the percentage from 100%, it shows how much of the business is financed by outside capital (creditors). When Net Worth is less than 50% of Total Assets, creditors have a greater interest in the assets than proprietors.

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Receivables Turnover

Repair Parts & Service Sales/Accounts Receivable = Receivables Turnover Ratio

Figure by dividing the total of Repair Parts and Service Sales by Accounts Receivable. The turnover rate is meaningful when customer receivables are related to the corresponding customer sales of the dealership. This ratio shows if receivables are in proportion to the amount of business transacted and may be used every month to good advantage. Divide Sales year-to-date by receivables and compare with the ratio for the same period in the past two or three years. Unfavorable trends can thus be detected.

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Net Working Capital Turnover

Current Assets – Current Liabilities = Net Working Capital Turnover Ratio

Net Working Capital is determined by subtracting Current Liabilities from Current Assets. Rate of turnover is figured by dividing Sales by Net Working Capital. The number of times Net Working Capital turns over in a year is a good measure of activity for any business. It is a sensitive indicator of over trading or under trading. It is also a good test of how adequate Net Working Capital is for the dealership's scale of operation. When the ratio is too high, it is usually because the dealership is short of cash, and heavy on receivables and paid-for inventory. This situation promotes borrowing, or sale of equipment at a loss, to meet payroll and other fixed obligations. When it is too low, inefficient use of capital in the receivables, inventory, cash or a combination of these is in excess of the needs of the business.

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Inventory to Net Working Capital

Inventory/Net Working Capital = Inventory to Net Working Capital Ratio

Calculate by dividing inventory by Net Working Capital. This ratio for most dealers is extremely high because inventories are characteristically heavy and represent a major portion of Total Current Assets, and because of heavy financing of wholegoods. In most other retail lines, inventory requirements are relatively smaller and supplier credit terms are shorter.

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Turnover of Total Assets

Sales/Total Assets = Turnover of Total Assets Ratio

Calculate by dividing Sales by Total Assets. This ratio is a measure of efficient use of assets. However, a high rate of turnover is not necessarily the key to profits. As in the ratio Sales to Net Working Capital, high turnover may be an indicator of inadequate capital in relation to sales volume. Also, high usage of rental property by a dealer usually results in a high rate of turnover.

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Return on Assets

Net Profit/Total Assets = Return on Assets Ratio

Calculate by dividing Net Profit by Total Assets. Return on Assets is a critical metric because it measures profits relative to total assets. This ratio is also an important test of operating efficiency. It is a test of management's use of the assets in the business. It lays aside all problems related to the source of funds, whether such funds are obtained from capital investment, borrowing, or purchase on credit. It shows the return on total capital invested in the business (owner capital plus outside capital), which is represented by Total Assets.

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Return on Net Worth

Net Profit/Net Worth = Return on Net Worth Ratio

Calculate by dividing Net Profit by Net Worth. Using this ratio, it is important that a fair salary for the owner be included in operating expenses of the business. The owner's time is certainly worth something. Therefore, all Net Profit ratios should be based upon the profit after this salary is paid. Adequacy of profit must be measured on investment returns, as well as compensate for risks.

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Inventory Turnover

Cost of Sales/Inventory = Inventory Turnover Ratio

Calculate by dividing Cost of Sales by Inventory. Cost of Sales figures are not reported in this study but should be figured by subtracting Margin from the corresponding Sales. This ratio shows the number of times inventory is bought and sold during the year, reflected in "Turnover" in the balance sheet study. Inventory includes both news and used wholegoods. It often also includes parts.