

Fourteen Key Business Ratios Used by D&B

Ratios are a means of highlighting relationships between financial statement items. Generally, ratios are used in two ways: for internal analysis of items in a balance sheet; and/or for comparative analysis of a company's ratios at different time periods and in comparison to other firms in the same industry.

D&B uses fourteen key financial business ratios to measure a company's solvency, efficiency and profitability. The ratios are divided into three groups:

- Solvency Ratios – measure the financial soundness of a business and how well the company can satisfy its short- and long-term obligations
- Efficiency Ratios – measure the quality of the firm's receivables and how efficiently it uses and controls its assets, how effectively the firm is paying suppliers, and whether the firm is overtrading or undertrading on its equity (using borrowed funds).
- Profitability Ratios – measure how well a company performs; analyze how profit was earned relative to sales, total assets and net worth.

Solvency Ratios (6)

Name	Function	Formula
Quick Ratio "Acid test" or "liquid" ratio	Measures the extent to which a business can cover its current liabilities with those current assets readily convertible to cash. Shows number of dollars of liquid assets available to cover each dollar of current debt. <i>Any time the ratio is 1:1 (1.0), the business is said to be in a liquid condition. The larger the ratio, the greater the liquidity.</i>	$\text{Cash} + \text{Accounts Receivable} \div \text{Current Liabilities}$
Current Ratio	Measures the degree to which current assets cover current liabilities. <i>The higher the ratio, the more likely the company will be able to meet its liabilities. A ratio of 2 to 1 (2.0) or higher is desirable.</i>	$\text{Current Assets} \div \text{Current Liabilities}$
Current Liabilities to Net Worth Ratio (%)	Indicates the amount due creditors within a year as a percentage of the owners' or stockholders' investment. Measures the funds creditors are risking with a business temporarily against the funds permanently invested by its owners. <i>Normally a business starts to have trouble when this relationship exceeds 80%.</i>	$\text{Current Liabilities} \div \text{Current Net Worth}$

Name	Function	Formula
Total Liabilities to Net Worth Ratio (%)	<p>Shows how all of the company's debt relates to the equity of the owner or stockholders.</p> <p><i>The higher this ratio, the less protection there is for creditors.</i></p> <p><i>If total liabilities exceed net worth then creditors have more at stake than stockbrokers.</i></p> <p><i>The difference between this ratio and Current Liabilities to New Worth Ratio is that it pinpoints the relative size of long-term debt, which can burden a firm with substantial interest charges.</i></p>	Total Liabilities ÷ Net Worth
Name	Function	Formula
Fixed Assets to Net Worth (%)	<p>Shows the percentage of assets centered in fixed assets compared to total equity.</p> <p><i>Generally the higher this percentage is over 75%, the more vulnerable a concern becomes to unexpected hazards and business climate changes. Capital is frozen in the form of machinery and the margin for operating funds becomes too narrow to support day-to-day operations.</i></p>	Fixed Assets ÷ Net Worth
Efficiency Ratios (5)		
Collection Period Ratio (Days)	Helpful in analyzing the collectibility of accounts receivable, or how fast a business can increase its cash supply.	Accounts Receivable ÷ Sales x 365 Days
Name	Function	Formula
Sales to Inventory Ratio	<p>Measures how fast inventory is moving the cash flow into the business.</p> <p><i>When this ratio is high, it may indicate a situation where sales are being lost because a concern is understocked and/or customers are buying elsewhere.</i></p> <p><i>If the ratio is too low, this may show that inventories are obsolete or stagnant.</i></p>	Annual Net Sales ÷ Inventory

Name	Function	Formula
Assets to Sales Ratio (%)	<p>Rates sales to the total investment that is used to generate those sales.</p> <p><i>If percentage is abnormally high, it indicates that a business is not being aggressive enough in its sales efforts, or that its assets are not being fully utilized. A low ratio may indicate a business is selling more than can be safely covered by its assets.</i></p>	Total Assets ÷ Net Sales
Sales to Net Working Capital Ratio	<p>Measures the number of times working capital turns over annually in relation to net sales. Should be viewed in conjunction with the assets to sales ratio.</p> <p><i>A high turnover rate can indicate overtrading (excessive sales volume in relation to the investment in the business). A high turnover may indicate that the business relies extensively upon credit granted by suppliers or the bank as a substitute for an adequate margin of operating funds.</i></p>	<p>Sales ÷ Net Working Capital</p> <p>or</p> <p>Sales ÷ (Current Assets – Current Liabilities)</p>
Name	Function	Formula
Accounts Payable to Sales Ratio (%)	<p>Measures how the company pays its suppliers in relation to the sales volume being transacted.</p> <p><i>A low percentage would indicate a healthy ratio. A high percentage indicates the firm may be using suppliers to help finance operations.</i></p>	Accounts Payable ÷ Net Sales
Profitability Ratios (3)		
Return on Sales (%) <i>Profit Margin</i>	<p>Measures profits after taxes on the year's sales (profits earned per dollar of sales).</p> <p><i>The higher this ratio, the better prepared the business to handle downtrends brought on by adverse conditions.</i></p>	Net Profit After Taxes ÷ Net Sales
Return on Assets Ratio (%)	<p>The key indicator of profitability.</p> <p><i>A high percentage tells you the company is well run and has a healthy return on assets.</i></p>	Net Profit After Taxes ÷ Total Assets
Return on Net Worth (%) <i>Return on Equity</i>	<p>Measures the ability of a company's management to realize an adequate return on the capital invested by the owners.</p>	Net Profit After Taxes ÷ Net Worth