BUSINESS EVALUATION

Analysing the financial health through ratio analysis

Area	Description		Ratio calculation	Your business ratio calculation	Industry average (if available)
1. Liquidity ratios Assess your business's ability to meet its obligations as they are due. In general, it is better to have higher ratios in this category as an indication of an ability to withstand tight-cash flow periods.	Current	The current ratio measures whether the business has enough current assets (cash at bank, debtors, inventory and other assets that can be turned into cash quickly) to meet its debts (current liabilities that are due in the next 12 months). A generally acceptable current ratio is 2 to 1, however, this will depend on the nature of the business and industry.	Current = Current assets / Current liabilities		
	Quick	The quick ratio helps answer a fundamental question for businesses affected by a disaster "if the business does not have any sales income, could the business meet its current obligations (without having to sell inventory at heavily discounted prices)?"	Quick = Current assets – inventory / Current liabilities		

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2. Solvency ratios These indicate the extent to which the business can meet all debt obligations from sources other than cash flow.	Leverage	The leverage (or gearing) ratio indicates the extent to which the business is reliant on debt financing versus owner's equity (the owner's financial contribution to the business). Generally, the higher the ratio, the more difficult it will be to obtain further debt.	Leverage = Total liabilities / Total current equity		
	Debt to asset	This ratio measures the percentage of assets being financed by liabilities. This ratio should ideally be less than 1, indicating there are enough total assets to meet all debt obligations.	Debt = Total liabilities / Total assets		
3. Profitability ratios These measure your business performance and ultimately indicate the level of success of your operations. You can use these ratios to assist in determining whether the pricing of your products and services were adequate to achieve a profit, the profit you wanted to achieve was being met, and how it	Gross margin	The gross margin ratio measures the percentage of sales dollars available to pay the overhead expenses of the business, after the cost of purchasing or manufacturing the business product.	Gross margin ratio = Gross profit / Net sales		
	Net margin	The net margin ratio measures the percentage of sales dollars left after all expenses (including stock), except income taxes. This ratio will provide an opportunity to compare your business's return on sales with the performance of other businesses in your industry.	Net margin ratio = Net profit / Net sales		

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compares with industry averages. These ratios can guide your pricing policy upon reopening.					
4. Management ratios These monitor how effectively you were managing your working capital. E.g. if the days you were taking to collect your debtors were longer than the days you were taking to pay your creditors, this indicates you were paying money out before you were receiving money for the same good or service. If this is the case, then upon reopening your business, you should seek longer terms of trade from creditors and try to reduce the length of time it takes to collect debts.	Days debtors	This ratio indicates how well cash from customers is being collected – referred to as accounts receivable. If accounts receivables are excessively slow in being converted to cash, the liquidity of your business will be severely affected (accounts receivable is the total outstanding amount owed to you by your customers).	Days debtors = Debtors / Net sales	X 365	
	Days creditors	This ratio indicates how well accounts payable are being managed. If payables are being paid on average before agreed payment terms and/or before debts are being collected, cash flow will be impacted. If payments to suppliers are excessively slow, there is a possibility the supplier relationships will be damaged.	Days creditors = Creditors / Costs of goods sold	X 365	

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5. Balance sheet ratios These indicate how efficient your business is using assets and equity to make a profit.	Return on assets	This ratio measures how efficiently profits are being generated from the assets in the business. This ratio will only have meaning when compared to similar businesses. A low ratio in comparison with industry averages indicates an inefficient use of business assets and something to be watched upon reopening your business.	Return on assets = Net profit before tax / Total assets	X 100	
	Return on Investment (ROI)	Assess your business's ability to meet its obligations as they are due. In general, it is better to have higher ratios in this category. The ROI perhaps is the most important ratio of all as it tells the owner whether or not all the effort put into the business has been worthwhile. If the ROI is less than the rate of return on an alternative, such as a low risk investment like bank savings, the owner may consider that option rather than funding the reopening of the business.	Return on investment = Net profit before tax / Total equity	X 100	

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How your business was running before the disaster?

Reviewing the way your business operated before the disaster and considering how you would like to operate the business in future will give you a clear picture on where to start, something that is often a difficult task following a disaster.

The analysis does not have to be a lengthy process, but it is important you take time to assess where you want the operations of your business to go and how you will get there. This could be a simple SWOT (strengths, weaknesses, opportunities and threats) using the template below. Areas that should be considered in the SWOT include operational procedures, marketing strategies, financial results, staffing, customers, potential markets and innovation.

Lessons learnt from the evaluation of your business before the disaster and your SWOT analysis should be incorporated into your recovery plan or new/revised business plan.

To assist in preparing the SWOT analysis, you might like to consider the below questions.

Evaluating your business	Yes	No	Comments / Notes
Is your business in the right location?			
Did your staff have the right skills to complete their jobs?			
Did you have the right level of staffing?			
Did you have the right mix of staffing (e.g. perm, part-time, casual)			
Did your technology need updating?			
Did you have an online presence?			
Were all your assets operating to maximum efficiency?			
Did you have adequate management/oversight of your cashflows?			
Was your pricing, services etc. competitive?			
Did you promote your business adequately?			

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SWOT Analysis Template

	Strengths	Strategies (Leverage)	Weaknesses	Strategies (Address)
Internal				
	Opportunities	**Strategies (Leverage)**	**Threats**	**Strategies (Address)**
External				

Adapted from CPA Australia Resources
Visit our Regional Restart Hub for more templates, checklists and mentoring support
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