Ratios are the objective way to measure your business performance.

Financial ratios provide an objective way to measure your company’s performance. Using the information on your financial statements, you can easily calculate various ratios and create a ratio analysis that gives you insights into performance over time, comparisons to competition and helps you measure against internal goals.

I’m not going to explain how to calculate the ratios in this video, as you can find that on our website. However, I am going to discuss what ratios can tell you.

- Profitability ratios indicate the financial viability of your business. They demonstrate how your company is generating profits from your operations.
- Liquidity ratios convey your company's ability to pay off its debt.
- Solvency ratios compare debt level with assets, equity and earnings, which evaluate how solvent the company is.
- Efficiency ratios convey the use of assets and liabilities to generate sales and create profits.

Consistent measuring is imperative in long-term decision-making. Ratios can easily be measured to compare performance over time, and to compare to similar industry standards. They will help you gain an understanding of where your company has been and where it could go over time.

Benchmarks can be created based on industry standards for like company structures. Start by selecting the ratios that best suit your needs and be careful to watch for seasonality influences. Measure your chosen ratios monthly, quarterly and yearly and then compare them to see the whole picture, enabling you to create goals based on performance. For example, you might be pleased that your revenue has increased over the years, but you may have a negative gross profit margin or a decrease in liquidity that is a more accurate representation of your company's financial health.

Let’s talk about the inventory turnover ratio, for example. Looking at inventory turnover over a year, you can see which months lagged or why certain months exceeded expectations. This can inform future purchasing decisions and indicate needed changes to your product mix. You can also measure how other company's inventory turnover compares to yours.

Measuring your cash flow margin ratio will convey your ability to convert sales to cash flow. This is a trusted ratio for measuring profitability, efficiency, and earnings quality.

Net profit margin is an essential indicator of the percentage of revenue left after all expenses have been deducted from sales. It reveals the amount of profit your business can extract from its total sales.

As you can see, there is a lot to measure, so work with your trusted advisor to establish a consistent ratio analysis process for your company.

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