**Statement of Financial Position: Ratios**

**Stakeholders affected by a business performance**

**Management**

They will want information to know how the business has performed over the year and to learn if any changes are needed. This will help make decisions if needed

**Shareholders**

They will want to know if the money that they have put into the business has been used wisely by the firm in order to generate profits and pay them a dividend

**Banks**

They want to know if the business is profitable enough to be able to make loan repayments and interest repayments

**Trade Unions**

They will keep an eye on the company’s profits because if they know the business is doing very well, they may look for wage increases

**Suppliers**

These are interested in a business’s accounts in order to assess the firm’s credit-worthiness

**Employees**

Will want to see if the firm is performing well for job security and promotion prospects

***So why does a business need Ratios?***

In the same way that a doctor examines a patient to find out what is wrong with him, a business must examine their accounts to make sure that it is in a healthy position.

In previous chapters we learned about Final Accounts for an organisation. In this chapter we learn about the ratios that can be used to assess performance.

**There are 3 main Ratio Categories:**

**Profitability-** Measures profits made by a business **(3)**

**Liquidity-** Ability to pay short term debts as they fall due **(2)**

**Gearing-**Looks at where the money comes from to run the business- the Financed By section. Having a lot of Debt Capital (Loans) can be a problem for a business as it must be repaid and has interest. **(1)**

**You can see the key Ratio Headings and figures based on the 2022 Mock Question below:**





**Note\* 2022 did not contain a loan (Debt Capital)**

1. **Profitability Ratios**



**Ratio Number 1: Profitability**

**Profitability:** This measures how successful the management of a business has been in making a profit



**73, 150/ 170,000 x 100/1 = 43.03%**



**9,250/170,000 x 100/1 = 5.44%**



**9,250/207,050 x 100/1 = 4.47%**

(This should always be compared with the risk free option offered by banks)

**Ratio 2: Liquidity**

**Liquidity:** This is the ability of a company to pay off its debts as they fall due.





**46,050:21,000**

**2.19:1**



**46,050-42,500: 21,000**

**3,550: 21,000**

0.17:1

(Big problem, a lot of money tied up in closing stock, may be difficult to sell)

**Ratio 3: Gearing**

**Gearing:** This ratio measures the amount of debt equity (loans) in a business compared to Equity Capital (Issued share capital and Reserves)

The formula for the Debt: Equity Ratio is:

Long Term Loans: Issued Share Capital + Reserves

These figures can be found in the Financed By section in the Statement of Financial Position



The ideal position is 1:1 or below.

Debt: Equity Capital =

**Long Term Loans: Issued Share Capital + Reserves**

**0: 200,000 + 7,050**

**This company did not have any debt capital, therefore:**

Debt/Equity Ratio is 0.

*We will now put all of these ratios into practice and be in a position to make comments with practice questions in class.*