



## CA - Spratt Business Competition Carleton University

### CA - SBC Tips & Strategy Sheet 9: Understanding Financial Ratios

When looking at your Firm Analysis, you'll notice several *financial ratios* at the bottom of the page. These decision-making aides are explained on the '*Terminology*' page under the 'Info' link on the website.

#### Understanding Ratios:

In the example on the right, the firm shows a **Return on Assets (ROA) of 20.36%**. This ratio is derived by dividing Net Income by Total Assets and tells you what earnings were generated from invested capital (assets). To increase this ratio, be sure that you invest enough into Plant & Equipment and produce enough so that your supply is meeting demand. If you invest too much, however, you will waste production capacity, which means you'll be stuck with assets that didn't produce sales. This will reduce your ROA. If you don't produce enough, you miss out on potential sales, which also lowers your ROA. The better you are at meeting demand, the higher your ROA will be. If it's going up, you're doing the right things; if it's going down, you may want to see how you can better meet your demand.

**Return on Equity (ROE)** is calculated by dividing net income by shareholder equity. Net Income includes all earnings a company realises after all costs, expenses and taxes are paid. In the simplest terms, shareholder equity is the sum of all direct shareholder investment in the company (capital stock) plus all indirect investment (retained earnings). You can gauge the success of your business by seeing if ROE increases or decreases from quarter to quarter. If your ROE increases over time, you're doing a good job of making money from shareholder investments.

The **Inventory Turnover Rate** measures the average number of times your inventory is sold per period. It is not provided for you, but it is another indicator that can assist you in CA - SBC. This rate is calculated by dividing your **cost of goods sold (COGS)** by your **average inventory**. If your inventory rate is rising over time, this means that you probably have less and less inventory available at the end of each period. This can be a good thing because unsold inventory costs money to store. Keep in mind, however, that if demand increases and you don't have a little extra inventory on hand you may have a shortage.

There are many more ratios that you can use to plan your strategy, such as the Debt Ratio, Equity Ratio, and Profit Margin. Hopefully this tips sheet helps you understand that ratios can be a great way to measure performance and plan strategy. While we can't go into detail on all of them, we encourage you to check out the '*Terminology*' page. There you'll find a whole library of ratios and terms that can help you not only better understand the language of business, but also make the most of your firm's investments.

Market Indicator	
Market Attraction:	21.84 %
Market Share:	23.08 %
Demand (Units):	3,333
Potential Sales (Units):	3,333
Supply (Units):	3,000
Sales (Units):	3,000
Unmet Sales (Units):	333
Financial Ratios	
Return on Assets:	20.36 %
Return on Equity:	20.36 %
Debt Ratio:	0.00
Equity Ratio:	1.00
Gross Profit Margin:	73.53 %
Profit Margin:	22.64 %
Total Cost / Unit:	\$114.24
Profit / Unit:	\$33.96

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