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Business Management, Inc.

CURRENT RATIOS

Applying Ratio Analysis to Financial Statements to analyze the success, failure, and progress of your business is a starting point for successful financial management.

Ratio Analysis enables the business owner/manager to spot trends in a business and to compare its performance and condition with the average performance of similar businesses in the same industry, watching especially for any unfavorable trends that may be starting. Ratio analysis may provide the all-important early warning indication that allows you to solve your business problems before your business is destroyed by them.

Important Balance Sheet Ratios measure liquidity and solvency (a business's ability to pay its bills as they come due) and leverage (the extent to which the business is dependent on creditors' funding).

The **Current Ratio** is one of the best known measures of financial strength.

Current Ratio = Total Current Assets, Including Inventory/Total Current Liabilities

The main question this ratio addresses is: Does your business have enough current assets to meet the payment schedule of its current debts with a margin of safety for possible losses in current assets, such as inventory shrinkage or uncollectable accounts? A generally acceptable collectable current ratio is 2 to 1. Whether, or not a specific ratio is satisfactory depends on the nature of the business and the characteristics of its current assets and liabilities. In theory, the larger the ratio is, the more liquid the business is.

If you feel your business's current ratio is too low, you may be able to raise it by:
- Paying some debts.
- Increasing your current assets from loans or other borrowings with a maturity of more than one year.
- Converting non-current assets into current assets.
- Increasing your current assets from new equity contributions.
- Putting profits back into the business.

More importantly, investors would look at the trend of the current ratio of the company, types of current assets the company has and how quickly these can be converted into cash to meet the company's current liabilities.

Using the Current Ratio is one step to begin to identify your business strengths and weaknesses.
Knowing "Your Business" requires work.

Find more valuable resources at www.on-trackinc.com

Accounting and Consulting for the Construction Industry

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