RATIO ANALYSIS

It is the most widely used tool since it compares risk and return relationships of firms from various aspects. Ratio analysis is the method or process by which the relationship of items or group of items in the financial statements are computed, determined and presented.

Liquidity ratios

These ratios analyse short term and immediate financial position of a business organization and indicate the ability of the firm to meet its short-term commitments.

Leverage ratios

These ratios measure the relationship between proprietor's funds and borrowed funds. They indicate the degree of debt financing in a firm.

Activity ratios

These ratios are designed to indicate the effectiveness of the firm in utilizing its funds, its degree of efficiency, and its standards of performance.

Profitability ratios

These ratios are intended to reflect the overall efficiency of the organization, its ability to earn a reasonable return on capital employed or on shares issued and the effectiveness of its investment policies.

DIFFERENT RATIOS

(1) Current Ratio = Total Current Assets/ Total Current Liabilities

(2) Quick Ratio = Total Quick Assets/ Total Current Liabilities

(3) Proprietary ratio = Shareholders' funds/Total assets

4) Best Possible DSO = (Current Receivables/Total Credit Sales) X (No. of Days)

(5) Inventory Turnover Ratio = Net Sales / Inventory

(6) Accounts Payables to Sales Ratio = [Accounts Payables / Net Sales] x 100

(7) Return on Assets = (Net Profit / Total Assets) x 100

8) Return on Equity or Net Worth = (Net Profit / Net Worth or Owners Equity) x 100

(9) Gross profit ratio = Gross profit/Net sales×100

(10) Net profit ratio =Net profit/Net sales×100

(11) Operating profit =Operating profit /Net sales×100

(12) ROI = Net profit before interest, tax and dividend /Capital employed×100

(13) Capital gearing ratio = Equity shares capital reserves and surpluses/Preference share capital + long term debt bearing fixed interest