Business Ratios and Break-Even Analysis

Business ratios explained

If you have your profit and loss statement, your cash flow statement, and your balance sheet, you have all the numbers you need to calculate the standard business ratios. These ratios aren't necessary to include in a business plan—especially for an internal plan—but knowing some key ratios is always a good idea.

Common profitability ratios include:

- Gross margin
- Return on sales
- Return on assets
- Return on investment

Common liquidity ratios include:

- Debt-to-equity
- Current ratio
- Working capital

Of these, the most common ratios used by business owners and requested by bankers are probably gross margin, return on investment (ROI), and debt-to-equity.

Break-even analysis explained

Your break-even analysis is a calculation of how much you will need to sell in order to “break-even” i.e., cover all of your expenses. In determining your break-even point, you’ll need to figure out the contribution margin of what you’re selling. In the case of a restaurant, the contribution margin will be the price of the meal less any associated costs. For example, the customer pays N500 for the meal. The food costs are N100 and the wages paid to prepare and serve the meal are N150. Your contribution margin is N250 (N500 – N100 – N150 = N250).

Using this model, you can determine how high your sales revenue needs to be in order for you to break even. If your monthly fixed costs are N50,000 and you average a 50 percent contribution margin (like in our example with the restaurant), you’ll need to have sales of N10,000 in order to break even.