

3.6 Efficiency ratio analysis (HL)

The big picture

An efficient business is one that is able to keep its costs and inputs low as it produces its goods or services. Efficiency also relates to how well a business is able to keep funds moving through the working capital cycle, which you learned about when studying liquidity ratios in [Section 3.5.3 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/liquidity-ratios-id-39308\)](#). The efficiency ratio measures how well a business has been able to manage its ongoing operations in the working capital cycle, which is shown again in **Figure 1**.

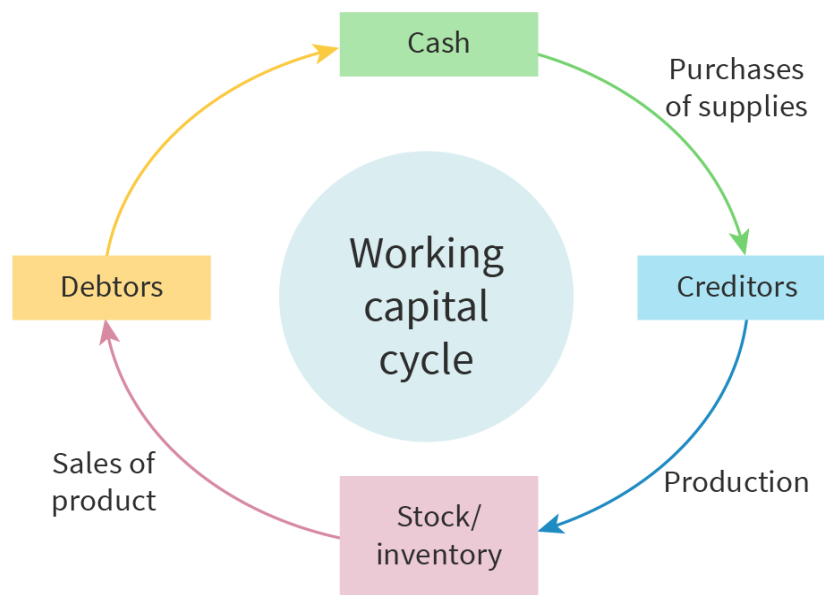


Figure 1. Efficiency ratios measure how well the business is managing its working capital cycle.

In this subtopic, you will learn how to calculate and improve each of the following efficiency ratios:

- **stock turnover ratio** (how quickly a business is able to sell its stocks)
- **debtor days** (how quickly a business is able to collect its debts)
- **creditor days** (how quickly a business pays its own debts)
- **gearing ratio** (the proportion of a business's capital that has been raised through potentially costly/risky long-term debt)

Can you see how each of these efficiency ratios relates to the working capital cycle? When that cycle breaks down, a business can become insolvent and may need to file for bankruptcy, a process that will also be examined in this subtopic.

Concept

Sustainability (economic)

Businesses/entrepreneurs are risk-takers that seek to make a profit and to continue their businesses. Sustaining business activity is especially important when businesses are providing for human needs, supporting the wellbeing of varied stakeholders in the community, and providing tax revenue to support public services.

Efficiency ratios, along with profitability and liquidity ratios, are important measures of economic or financial sustainability of a business. Given the many relationships that businesses have with varied stakeholders, businesses have a responsibility to monitor their financial performance and health in order to ensure that the business endures.