

Is Your Business Healthy?

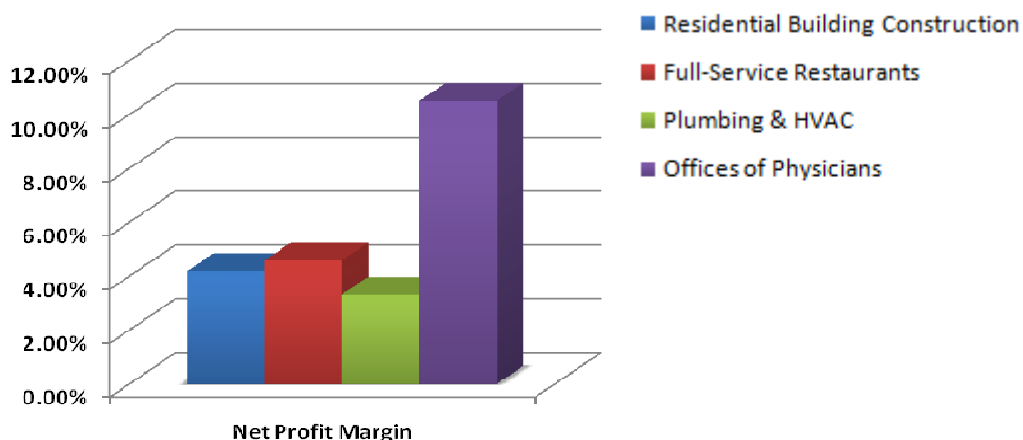
By Brad Schaefer, Analyst, Sageworks, Inc.

Benchmarking the financial performance of your business against that of your peers is an important aspect of running and growing your business. It is also a quick and easy way to assess its health. Comparing yourself to your competitors can help highlight trouble areas and can serve as red flags for you. As Chad Parker, a Partner at Sink, Gillmore & Gordon LLP accounting firm puts it, “Industry comparisons are a valuable part of understanding and improving business performance as they can point out areas that business owners need to take a look at and see why they are performing below the rest of the industry.” But, before you find true value from these comparisons, you will need to decide which financial metrics are important to you and understand what they actually mean. After you complete these two steps, finding quality industry data to benchmark yourself against is the third important step in getting true value from industry comparisons. Trade associations are a great place to start looking for industry data since their members often contribute financial and operational data through surveys. Smaller businesses may also consider reaching out to the local business development center which may have access to comparable resources.

Below are generally the most important financial metrics to focus on when looking at industry benchmark data and a short explanation of what they actually mean. Also included with each type of ratio are private company industry data statistics based off data from the past 12 months. The industries looked at here are Residential Building Construction, Full-Service Restaurants, Plumbing & HVAC, and Offices of Physicians.

1) Net profit Before Taxes Margin

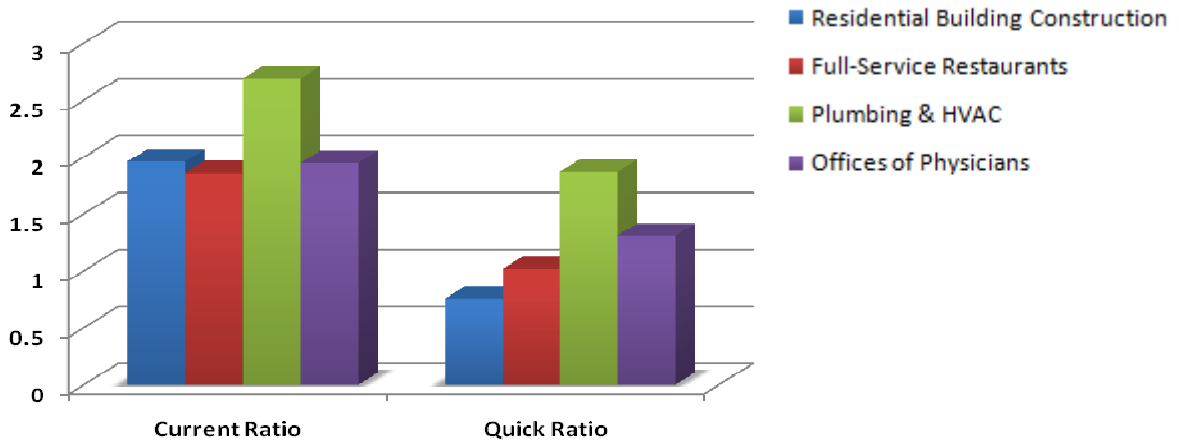
Net profit margin is generally expressed as net profit before taxes in a given financial period divided by sales. Another helpful interpretation is how many cents of profit a business extracts from each dollar it earns in revenue. This is a basic financial metric, but it is also *the* most important.



2) Liquidity Ratios

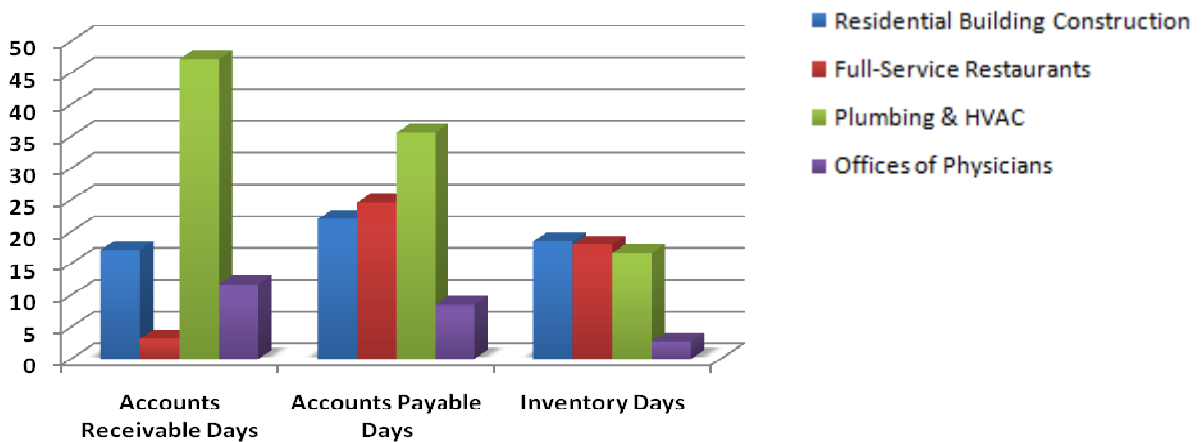
There are two fundamental liquidity ratios that should be analyzed jointly. Current Ratio is expressed as current assets divided by current liabilities. This metric shows the company’s general liquidity, but it has some limitations. For example, by including inventory in the calculation, it may provide a distorted understanding of the company’s very short-term cash flow. The second liquidity ratio is the Quick Ratio, which is typically expressed as cash plus accounts receivables

divided by current liabilities. Again, the Quick Ratio may not be perfect for gauging liquidity, but it is a useful and popular comparison to pair with the Current Ratio.



3) Turnover Ratios

There are three fundamental turnover ratios that you should calculate. Accounts Receivable Turnover, in days, is expressed as accounts receivable divided by sales multiplied by 365 days. It roughly measures the number of days a company takes to turn accounts receivable into cash. Lower numbers are more desirable since it better to have cash in your bank account. The second ratio, Accounts Payable Days, is expressed as accounts payable divided by cost of goods sold multiplied by 365 days. The Accounts Payable Days ratio indicates the number of days a company takes to pay its vendors. Here, higher numbers are better because it means you are able to hold onto your cash longer. The third turnover ratio, Inventory Days ratio, is expressed as inventory divided by COGS multiplied by 365 days. The Inventory Days ratio measures the number of days it takes to sell inventory, but it is very specific to your industry. Generally, lower numbers are better.



About Brad Schaefer: Brad Schaefer is an Analyst at Sageworks, a financial information company and developer of the [financial analysis software](#) suite ProfitCents. Schaefer has led the development and ongoing enhancement of Sageworks' credit risk management solution for financial institutions. He received his degree from the Poole College of Management at North Carolina State University where he graduated summa cum laude.

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