Guidelines on how to answer a question with ratios

> 1. **Definition, with calculation**
> 2. **State Figures – analyse what they mean using £1**
> 3. **Compare to the ideal figure, compare to last year's figure**
> 4. **Make a judgement, could they improve?**

Definition	Why it is useful	Analyse	Ideal	Improve
ROCE Net profit before interest/ T.A – C.L x100	Tells how much £ is made by business compared to how much is being invested	e.g. 20% For every £1 invested the business makes 20p net profit	The higher the better. Compare to bank interest rates	Sell assets improve productivity to improve profitability
Gross Profit Gross Profit/Sales Rev x 100	If a business is controlling its direct costs,	e.g. 20% for every £1 of sales, 20p is gross profit Compare to last yr	Higher the better Dependent on industry	Raise sales Reduce costs
Net Profit NP before interest/sales rev x100	More accurate as fixed overheads are accounted Indicates the profitability of running the business	e.g. 20% for every £1 of sales, 20p is net profit Compare to last yr	Higher the better Should be consistent	Raise sales Reduce costs
Current Ratio C.A/C.L x :1	Liquidity – ability to cover day to day expenditure	e.g. 1.5; 1 for every £1 debt, £1.50 in assets	1.5: 1 Low – can't pay debts High – wasteful	Sell assets Increase borrowing Put off investments
Gearing Non C.L/ Ord Share Funds+ Non CL x100	How reliant a firm is on borrowed money/ risk Where firms get finance from Risk from interest rate changes	e.g. 30% for every £1 of capital employed 30p has been borrowed	No greater than 50% 25% low – risk averse	Pay back debt Sell shares
Earnings per Share Profit after Tax/ No.of ord shares = pence	Financial reward for shareholders. How much should be paid from profit	Compare to previous years May not be paid out	Higher the better	
Return on Equity Profit before tax-pref dividend/ ord share cap +Res x100	How much equity is available for shareholders	Compare to previous years May not be paid out	Higher the better	