How healthy is your business?

Six key ratios to follow

Here are six key ratios you should know to see how your company is performing. All ratios should be considered in light of the industry and the relative stage of a company (growth or mature).

Current Ratio — Indicates the company’s ability to pay its short-term liabilities. For instance “we have $100,000 in cash, accounts receivable and inventory and we owe $50,000 to vendors”. Anything over 1.0 is acceptable; and over 2.0 usually means that you are in a great position to cover your immediate debts!
Calculation: Current Assets / Current Liabilities

Quick Ratio — Similar to the current ratio in that it also indicates the degree with which you can cover your short-term liabilities. However, the quick ratio removes all current assets that are not easily convertible to cash on short notice, e.g., inventories.
Calculation: Cash + Cash Equivalents + Accounts Receivable / Current Liabilities

Capitalization Ratio — An indication of the overall strength of a company and the company’s ability to sustain itself in tough times or in periods of growth. Debt needs to be paid regardless of the economic conditions. Generally speaking, the lower the number, the stronger the company.
Calculation: Total Long-Term Liabilities / Total Long-Term Liabilities + Equity

Pre-tax Profit Margin — Tells you how much of your revenue you are keeping. Start-up and early-stage development companies will most often show a negative margin (i.e., the pre-tax profit is in fact a loss) because you are investing in your business. If you are looking at a mature business, a healthy margin may be north of 25%.
Calculation: Pre-tax Profit / Net Revenue

Sales per Employee — Is a relative efficiency measure for your business. Generally, a high-investment tech or capital-intensive manufacturer will have a higher number than a labor-intensive retailer. But again, industry standards are a key to understanding your own efficiency.
Calculation: Net Revenue / Number of Employees

Burn Rate — The negative cash flow of a company. The rate is usually associated with a start-up/high growth company and stated in terms of amount per month. For instance, a company that spends $500,000 on operating expenses and capital investments and takes in $400,000 per month in revenue has a burn rate of $100,000.
Calculation: Net cash outflow less net cash inflow.

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