External factors

- stage of economic cycle (e.g. boom or recession)
- government legislation, which may add costs or create markets.
- changes in taste- in favour/against firm's products.
- new technology leading to new products/processes in the market.
- level of comp, which can affect the ability of a firm to make money.
- it is vital that these and other factors are considered before conclusions are drawn.

Conclusion

- ratios must not be ignored.
- they are an excellent guide to performance.
- however, conclusions should be based on the specific circumstances, and the problems and limitations involved in ratio analysis should be borne in mind.

Ratio analysis: choosing the right ratio(s)

RATIO	MAIN PURPOSE
ROCE (%)	-to assess whether a business is making a satisfactory level of profit from the capital available to it.
Current Ratio	-to see if a business is likely to run short of liquid assets in the short-term. -to see if a cash flow problem might occur in the short-term.
Acid Test Ratio	-to see if a business has sufficient liquid assets in the short term, even if it has difficulty selling its inventories. -to see whether a cash flow problem might occur in the short term, especially if the business cannot rely on receiving cash from selling its inventories.
Gearing (%)	-to measure how reliant a business is on borrowed money. -to study the likely impact on the costs of a business and if there are any changes in interest rates. -to gauge whether a business may be vulnerable from having to repay loans in the next few years
Asset Turnover	-to measure the efficiency of a business in terms of how well it uses its assets to generate sales revenue.
Inventory Turnover	-to calculate how many times a year a business is able to sell its stock. -measure the speed to which a business is able to convert its inventories into sales.
Receivables Days	-to discover the time taken for receivables to pay their debts to the business. -assess whether individual receivables are possibly going to become bad debts.
Payables Days	-discover time taken for a business to pay its debts to its payables. -assess whether business is in danger of defaulting on the debts it owes.
Dividends per share	-calculate direct financial reward that a shareholder will receive from the company every 6 months, in return for owning its shares.
Dividend yield (%)	-assess percentage return a shareholder receives from a share, based on the assumption that the shareholder is considering purchasing shares at the current market price. Return can be compared to current interest rates or savings in banks.

Formulae for financial ratios

1. Current ratio: current assets: current liabilities

2. Acid test ratio: liquid assets: current liabilities OR current assets-inventories: current liabilities