FINANCIAL RATIOS FOR EXECUTIVES

HOW TO ASSESS COMPANY STRENGTH, FIX
PROBLEMS, AND MAKE BETTER DECISIONS

Michael Rist

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Apress®

Financial Ratios for Executives: How to Assess Company Strength, Fix Problems, and Make Better Decisions

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Preface

We wrote this book specifically for today's global financial and nonfinancial executives who are looking for an easy-to-use reference book on financial ratios and capital allocation to assist them in operational and strategic decision making. Our aim is to make financial ratios simple and intuitive for everyone to understand.

This book contains over one hundred financial ratios and other calculations commonly used in businesses around the world—including *return on investment* (ROI), *return on assets* (ROA), *return on equity* (ROE), *economic value added* (EVA), and *debt ratio* just to name a few.

We have also included a section on what financial and nonfinancial executives need to understand about capital allocation before entering the annual budget meeting or any other business meeting in which capital allocation is discussed. This section describes tools such as *net present value* (NPV), *internal rate of return* (IRR), the *payback method*, and *total cost of ownership*.

Given that a good understanding of financial ratios, valuation tools, and return on investment calculations are important components of any business system, we set out to create a simplified handbook with short descriptions, calculations, and examples for each of the ratios.

It is important to note that financial analysis is not always black and white. Two experienced finance people can sit down with identical financial information for a company, come up with different ratios, and both be right. Often, financial analysis is more of an art than a science. Accounting and business have their own language and, as with any language, sometimes the same words can have different meanings to different people. Always bear in mind that the particular meaning of a general ratio depends on context.

Consistency is key. Sometimes certain adjustments, such as non-recurring items, are made to specific line items, so as long as you are consistent in doing the same calculation year over year or when comparing companies against each other, your comparisons still have meaning. It may not matter if another accountant, colleague, or business manager gets a different answer; it is the internally consistent comparison and the underlying analysis that matter.

Microsoft Excel has built-in functions for some of the calculations in this book, such as IRR and NPV. The built-in functions may calculate ratios slightly different than the mathematical formulas do. Again, however, as long as you consistently use the same tool, any disparity between tools may not be analytically significant.

Some ratios are known by multiple names (e.g., the *acid test* is also known as the *quick ratio*). For completeness and easy reference, all ratios are duplicated under each name so no back-and-forth page turning is required.

In some of the examples we have also given our readers a sense of the normal ranges of values for specific ratios in various industries.

Remember, the tools described in this book are just that—tools. Whether one carpenter uses a hammer slightly differently than the next carpenter does not matter as long as the job gets done properly. Provided you use the tools in this book consistently and with good business judgment, they can help you make good business decisions.