Business Resilience Toolkit

Financial ratios

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Transcript:

The famous management author Peter Drucker once said: “If you can’t measure it, you can’t improve it”.

Put another way using the old cliché: “what gets measured gets done”.

Recording and measuring the right data and metrics is essential to knowing how well your business is performing. In this video, we are going to look at three of the key financial ratios that can help ensure your **business resilience**.

Hi, my name is Andrew Ellis and I’m a business consultant with CBB.

With the right financial system, in particular a modern accounting system, you should able to regularly review key results against target, and calculate ratios that provide insights to the way your business operates.

In this video, we are looking at ratios that point towards your **longer term business resilience**. At CBB, our focus is on the not for profit sector, but also, much of our work relates to aged care and disability services. So, as far as context is concerned, we understand that every organisation is different but the ratios we are talking about today are especially relevant to aged care and disability services.

The first ratio to consider is **Revenue – and margin – diversification**. This is about looking at the percentage of your revenue – and gross margin (before overheads) – that comes from each area of your business. Small, start-up and niche businesses might all focus on one main revenue source, but medium to larger organisations will have multiple revenue sources. This could come from different products, services, locations and even different clients. You can calculate what percentage of revenue is dependent on a single source – whether that source is a single service, location, grant or client. The more diverse your revenue sources – whilst still staying true to your skills and vision – the more resilient you will be.

You can apply the same logic to your gross margins as well. That is, calculate what percentage of your margin comes from each source. Being overly dependent on one source would have an impact on business sustainability or resilience if that was lost.

The second ratio is **Wages as a percentage of revenue**. We use this because wages in the aged care and disability services sectors make up a significant proportion of the expenses of the organisation. Other not for profit organisations may have a different business model making this ratio less relevant, but reviewing wages as percent of revenue against historical performance in your organisation can provide insights. It can tell you if you are getting enough value from your key resources. Looking say at annual results, what if you are spending 5% more of your revenue on wages now than 3 or 4 years ago? Well, what has that meant to your margins

and surplus? It could be that there is a slow increase on wages relative to revenue which is eroding longer term surpluses and sustainability.

Thirdly, Direct worker utilisation which is the billable hours divided by the total hours – for your staff who are client facing and chargeable. So, for example, disability support workers spend time with clients where you charge for the services; and there is other time perhaps for training, meetings, supervision, administration etc which is not able to be charged for. Utilisation refers to the percentage of time that these workers are chargeable for the role they do. In this area, you should have annual targets and budgets. And be measuring weekly.

For each of these ratios, you should be able to:

- Compare actual results against their respective targets on a regular basis; and
- Compare results against historical norms.

You *might* also consider whether you could compare your own numbers against competitors (if known). There's obviously a risk of comparing apples with oranges instead of apples with apples, but if you can access data on a competitor organisation, then it can provide insights to compare ratios from your organisation against theirs. Look out for benchmarking studies in your sector, if you're interested in comparisons with your peers.

In reporting on these ratios, having systems in place to review these as early as possible will significantly improve your ability to undertake corrective actions and ensure the sustainability of your operations. For example, measuring worker utilisation on a monthly basis means that – if results are not good - the month has passed before you can start to take action. I like to monitor this weekly, so that you can see where issues are emerging and take early action.

So there you have it, three key ratios that will help you understand longer term business resilience: revenue diversification, wages as percentage of revenue and worker utilisation. I suggest you pull out your most recent reports and see if you can calculate what these ratios are now, compare with previous results and see if any further action is required.

Related videos to watch next: Billable and non-billable time, and revenue diversification.