Sainsbury’s ratio analysis

Ratio Analysis can make accurate judgements of an organisation's performance. Ratio Analysis could also be useful to many stakeholders in the business.* It helps Owners to inform them when they are looking to make decisions about the future of the business.* It helps investors to check that their investment is doing well and providing a fair return on their money.* Suppliers, if they are owed money by the business then they will want to know If they are likely to get their money back.

* It helps employees to check the accounts to monitor how profitable the business is and therefore whether they can request pay rises or improvements on their working auditions.* It also helps customers to check that the business is likely to be financially healthy and therefore able to keep supplying them. Under the Ratio Analysis, there are three main headings that I have used to calculate Sainsbury's performance: 1 Profitability – These analyse the profit made over the last year. 2 Liquidity – These measure the solvency of the business and its ability to meet short-term debts.

3 Efficiency (Working Capital Management) – These analyses the efficiency of the business in terms of the use of its resources in generating sales. ProfitabilityProfitability is a factor that is most important to owners of business is its profitability. The following ratios can help monitor the company's profit performance.* ROCE (Return on Capital Employed)This is often referred to as the ' primary accounting ratio' and it expresses the annual percentage return that an investor would receive on their capital.

It basically relates the profit to the size of the business. This shows us the percentage return that the investors have received on the capital that invested. Sainsbury’s (ROCE)In the year of 2006 the Sales turnover of Sainsbury’s is six times less, approx than in 2007 at 5. 0%. The ROCE for both years is not much although 2007 has a higher ROCE.* Gross Profit percentage of Sales.

This measures the gross profit of the business as a proportion of the sales revenue. This also shows how much gross profit is being made compared with the sales mode. It is useful to compare the figures from one year to the next, and ideally the percentage will stay relatively stable. Sainsbury’s (Gross Profit)The gross profit percentage for Sainsbury’s is 6. 6% for 2006 and 6.

8% for 2007. This means that for every ï¿½1 of sales revenue, 6. 6 pence and 6. 8 pence respectively remains after all direct expenses have been deducted. This money then contributes towards covering the other expenses of the business.

The business would want this margin to be as high as possible, since a high margin will leave more profit for covering the remaining expenses. The percentage figures indicate that because they have a higher gross profit in 2007, this might be that they had a cheaper source of supply.* Net Profit percentage of SalesThis measures the net profit of the business as a proportion of the sales revenue. This is similar to gross profit percentage but this time shows how much net profit is being made compared with sales.

It is useful to compare the gross profit percentage with the net profit percentage as this shows how much of gross profit is being taken up by the expenses. A fall in Net Profit percentage would indicate that expenses were increasing and this should be examined to see where the problem is and what could be done to put it right. Sainsbury's (Net Profit)The net profit percentage of Sainsbury's is 0. 6% and 2. 8% for 2006 and 2007 respectively. This means that for every ï¿½1 of sales revenue, 0.

6 pence and 2. 8 pence remains after all direct and indirect expenses have been deducted. This money then contributes towards covering the corporation tax that must be paid on profits to the Inland Revenue. These figures also indicate that expenses in 2006 were therefore greater than 2007.

LiquidityAs we have seen, working capital is essential to the health of a business. The following ratios are commonly used to measure how solvent the firm is, i. e. how easily it can pay its debts.* Current RatioThis measures current assets as a proportion of current liabilities.

This ratio shows the proportion of current assets to the current liabilities. It shows how easily the business could raise enough money to pay the debts that it has to pay in the near future. Sainsbury's (Current Ratio)The current ratio of 0. 8: 1 for 2006 is below the acceptable ratio. This means that for every ï¿½1 of current liabilities, the business has ï¿½0.

80 of current assets available. At 0. 7: 1 for 2007 is also below the acceptable ratio of 2: 1 and lower than 2006's figure. A figure less than 1. 5 indicates that the business may experience difficulties in meeting its short-term debts.

These figures show the signs of liquidity problems at previous years.* Acid test Ratio/Liquidity RatioThis measures current assets less stock as a proportion of current liabilities. The reason for this is sometimes it is difficult to sell stock quickly. Therefore, the ratio shows how much readily available assets the business could rely on if a creditor insisted on immediate payment.

The lower the ratio, the more liquid is the business and the closer it is to insolvency. If the business has a healthy current ratio but a poor acid test ratio, it might be that the business is holding too much of stock. Sainsbury’s (Acid test Ratio)The acid test ratio of 0. 7: 1 for 2006 highlights that Sainsbury’s has serious problems. 0. 7: 1 means that for every ï¿½1 of current liabilities, the business has ï¿½0.

70 of cash available at short-notice. A figure less than 1 indicates that the business may experience difficulties in meeting its short-term debts and the company is in danger of bankruptcy. The ratio of 0. 5: 1 for 2007 shows that it is not secured as the liquidity problems has increased from the last year. An answer of less than 1. 0 also indicates that Sainsbury’s may not be holding cash in a productive and profitable form.

Efficiency/Working Capital ManagementThese ratios examine the productivity of a business. Productivity looks at how efficiently a company is using its factors of production to produce goods/services and profit.* Rate of Stock Turn overThis measures the number of times in a 12-month period that a business sells its stock. This ratio returns the number of days that on average item of stock is held at the business.

In other words how long it takes the business to sell the item. Sainsbury’s (Stock turnover)Sainsbury’s turned its stock in 14 days in 2006 and 13 days in 2007. The acceptable number of days should be turning the stock before 30 days. This means that Sainsbury’s is turning its stock very fast, they are not keeping the stock for longer in the warehouse. The speed of turning its stock has got better from 2006. Conclusion(D2)ProfitabilityThese ratios can show how profitable a business is over a time.

There are three ways of working out how profitable a business is: Gross Profit %, Net Profit % and Return on Capital Employed (ROCE). Sainsbury’s (Profitability)Both of the years have an acceptable profitability but 2007’s performance is better in this area. This could be because they have bought the stock from a cheaper supplier to keep the expenses lower than the last year (2006) which has made Sainsbury’s perform better at this stage. Sainsbury’s has not got a high gross profit in 2006 or 2007 but I think higher gross margins are preferable to lower ones. However, they vary significantly according to industry type. As a rule, the quicker the turnover of stock is, the lower the gross margin.

To increase the gross profit, Sainsbury’s should increases it’s selling prices, if raw materials and wages go up a lot, the gross profit margin will go down. A high gross profit % would shows that the business is doing well as it is controlling the cost of its purchases. Net profit shows how well Sainsbury’s manages its other expenses. Net profit of 2007 seems quite low, ï¿½2. 90 of every ï¿½100 of sales.

Where as 2006’s performance has a large gap between gross profit and net profit which indicates that in the year of 2006, costs were rather high than in 2007. When it is compared to the gross profit % and Sainsbury’s have a higher gross profit percentage but a low net profit % means that their operating costs (i. e. day-to-day running costs such as wages, rent and insurance) are too high as they are taking out too much of profit from the business.

This means that action to reduce operating costs must be put in place. This ratio is calculated to judge profitability. It shows the amount of money an investor is receiving back on their capital as a %. The ROCE in 2007 is 5. 0% which is at a reasonable stage means that if all sales revenues are disappeared, Sainsbury’s will still be able to meet its current obligations with the readily convertible funds on hand. The interest rate at the bank is higher than that is seen, means that it would make investors to think before they put the money in.

Liquidity: Businesses can ratios to work out their liquidity by using the Current Ratio and Acid test Ratio. These ratios allow businesses and potential investors to see how well they are able to meet their liabilities. Sainsbury’s (Liquidity)Sainsbury’s liquidity stage is their weakness as it is quite poor and unacceptable in the market. Liquidity ratios are unacceptable as they are below the normal.

The current ratio looks reasonable for 2006 as current assets are nearly 0. 6 times as much as current liabilities. The acid test ratio for 2006 also shows a good picture than the 2007 but both years’ ratio is under the acceptable of 1. 5: 1.

The current ratio for both years is below 1. 5: 1. It might be argued that the company does not have enough working capital. Sainsbury’s has poor liquidity ratios in both previous years means that it could have any liquidity problems as the ratios are below the norm which also means that investment in Sainsbury’s might not profitable or a secured investment. Sainsbury’s acid test ratio shows that even with stocks taken out of the current assets, there is not a big gap between current an liquidity ratios means the company still has sufficient liquid assets to cover it bills. If Sainsbury’s current ratio are healthy would mean that the company should not find difficulties meeting debts that need to be paid in the near future.

But it should be between 1. 5 and 2. 0, so that Sainsbury’s can be sure of it can pay its liabilities and higher than 2. 0 would not be good as the money could be used elsewhere to improve the business. Working Capital Management: These ratios that a business might use are those that determine performance of business and this show the Stock Turnover, Debtor’s collections period and Assets turnover. Sainsbury’s (Working Capital Management)I think both years are strong at efficiency stage.

Its quick turnover contributes to the minimum amount of creditors. Sainsbury’s is taking 14 days to sell stock in 2006 seems quite a good time, It would be helpful to compare this with previous years to check that the situation. 2007’s stock turnover is faster compared to 2006’s. A quick stock turnover means that profit on the sale of stock is earned faster but quicker turnover could be one of the reasons of their low gross profit margin. They are not keeping the stock in the warehouse for too long means that it's not having them to increase their fixed assets. The efficiency ratios for Sainsbury's last two years also show that they are working towards managing its working capital effectively.

RecommendationsI would recommend investing in Sainsbury's now because they have a good profitability at the ROCE of 5. 0% in 2007 which had growth of approx 4. 2%, it's not that high as it's still lower than the bank interest rate. But I think if Sainsbury's achieves the same growth percentage this year in ROCE then return on investment could go up to 9.

2% in 2008. Sainsbury's also have enough current assets to meet the payment schedule of its current debts with a margin of safety for possible losses in current assets. Effectiveness of Ratios (D2 – continued)One of the key reasons for producing financial information in terms of the balance sheet, profit and loss account and cash flow statement, is to provide more information and details that can be used by the different stakeholders for making decisions in an organisation. In order to do this effectively, accurate interpretation and assessment of account needs to be carried out. A technique for doing this is a ratio analysis, providing a more meaningful picture of the performance of a business. Ratio analysis isn't just comparing different numbers from the balance sheet, income statement, and cash flow statement.

It's comparing the figures against previous years, other companies, the industry, or even the economy in general. Ratios look at the relationships between individual values and relate them to how a company has performed in the past, and might perform in the future. Financial ratio analysis is the calculation and comparison of ratios which are derived from the information in a company’s financial statements. The level and changes of these ratios can be used to make inferences about a company’s financial condition, its operations and attractiveness as an investment.

A financial ratio can give a financial analyst an excellent picture of a company’s situation and the trends that are developing. Examples: The importance of ratios to stakeholders depends on who they are and what they are trying to find out.* A potential shareholder will pay more attention into account of profits after tax of a firm and how much return on the capital employed or net assets.* A bank manager would confirm if the firm has enough liquid assets to cover its short-term debts.

* The sales director of the firm will be concerned with how many the sales in relation to the profits the firm has made. The ratios are based on the different measurement of performance. These are divided into three groups namely profitability ratios, liquidity ratios and efficiency ratios. Ratio analysis will be a relatively effective and powerful technique in the interpretation and assessment of business performance when applying it to comparisons.