Centre for Excellence

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Ratio Analysis

Q.NO.1:- who are the interested parties in Financial Statements analysis?

Ans:-

i. **Management:-** for day to day decision making and also for performance evaluation.
ii. **Shareholders:** For analyzing performance, profitability and financial position.
iii. **Lenders:** For determining financial position of the company, debt service coverage etc.
iv. **Suppliers:-** To determine the credit worthiness of the firm in order to grant credit.
v. **Customers:-** To know the general business viability before entering into long-term contracts.
vi. **Government:-** To ensure prompt collection of direct and indirect taxes.

Q.NO.2:- What are the techniques of Financial statement analysis?

Ans:-

i. Ratio analysis
ii. Cash flow statement
iii. Funds flow statement
iv. Trend analysis
v. Comparative financial statement
vi. Common-size statement
vii. Value Added statement

Q.NO.3:- What is the significance of Ratio analysis?

Ans:-

i. **Evaluation of profitability:-** Profitability ratios i.e. gross profit ratio, net profit ratio, operating profit ratio are basic indicators of the profitability of the firm.
ii. **Evaluation of Liquidity:-** The ability of the firm to meet short term commitments is called liquidity. Current Ratio and quick ratio help to assess the liquidity position of the firm.
iii. **Evaluation of operating efficiency:-** Ratios through light on the degree of efficiency in the management and utilization of assets and resources. These are indicated by Activity /Turnover ratios like stock turnover , asset turnover, debtors turnover, fixed assets turnover etc. These indicate the ability of the firm to generate revenue per rupee of investment in its assets.
iv. **Evaluation of financial strength:-** Log-term solvency is indicated by capital structure ratios like debt equity ratios , gearing ratio, leverage ratio. These ratios signify the effect of various sources of finance,. They also show whether the firm is exposed to serious financial strain or is justified in the use of debt funds.

Q.NO.4:- Outline the limitations of Ratio analysis.

Ans:-

i. **Window dressing:-** Ratio depict the picture of performance at a particular point of time. Sometimes , a business can make year end adjustments in order to result in favourable ratios.
ii. **Impact of inflation:-** Financial statements and ratios are effected by inflation. For example fixed assets are accounted for at historical cost and profits are measured incurrent rupee terms. In inflationary condition, ROA and ROCE may be very high due to less investment in fixed assets.
iii. **Difference in accounting policy:-** Different firms follow different accounting policy, e.g. rate and methods of depreciation. In such a situation comparison of ratios among the firms may give misleading results.
iv. **Lack of standards:-** even though some norms cab be set for ratios, there is not uniformit as to what an ideal ratio is
v. **Inter-dependence:-** Financial ratios cannot be considered in isolation. Decision taken on the basis of one ratio may be incorrect when a set of ratios are analysed.

SUMMARY OF RATIOS

1. LIQUIDITY/SHORT-TERM SOLVENCY RATIOS

Formula	Factors	Ideal norm
Current ratio		
Current Assets /Current Liabilities	Current Assets = Closing stock + Debtors + Bills Receivable +Prepaid Expenses+ Advances Given + Cash at Bank + Cash in hand. Current Liabilities =Creditors + Bills Payable + Outstanding Expenses + Tax Liability + Bank Overdraft (short-term) Proposed Dividend	2 : 1
Significance: ➢ A comparatively higher current ratio indicates a good liquidity and satisfactory debt repayment capacity of the firm. It is also an indicator of safety of investment made by creditors. ➢ A low current ratio than the standard indicates a bad liquidity, over-trading, less working capital and unsatisfactory debt repayment capacity of the firm. The investment of creditors in a firm having a low current ratio may not be too safe		
Liquid /Quick ratio		
Quick or Liquid Assets /Quick or Liquid Liabilities	**Terms** Quick or Liquid Assets = Current Assets - (Stock and Stores + Prepaid Expenses) Quick or Liquid Liabilities =Current Liabilities - Bank Overdraft (short-term and not payable on demand)	1:1
Significance: ➢ A high quick ratio along with a high current ratio indicates a good short-term solvency or debt repayment capacity of the firm. ➢ Even if the current ratio is high, a low quick ratio does not indicate a good debt repayment capacity of the firm. ➢ The quick ratio is considered to be a better test of liquidity than the current ratio.		
Absolute cash ratio/ Absolute liquid ratio		
Cash/Bank + marketable securities/current liabilities	Cash+ marketable securities+ short term investment+ bank balance	No ideal ratio, if the ratio>1 , it indicates very liquid resources .
Significance: Availability of cash to meet short –term commitments Note :- Above ratios are expressed in times.		

PROFITABILITY RATIOS

Formula	Factors	Ideal norm
Gross Profit Ratio		
Gross Profit/sales	Gross profit as per Trading account Sales less returns	absent
Significance: ➢ A higher:- gross profit ratio indicates more profitability and managerial efficiency		

- A lower gross profit ratio reveals the weak profitability and managerial inefficiency.
- The gross profit ratio reveals the efficiency in the operating activities of the firm.

Net Profit or Net Margin Ratio

Net Profit/net sales	Net Profit after tax as per P/L account.	absent

Significance:

- The net profit ratio shows the net contributions made by sales of rupee 1 to the owners' fund.
- A higher net profit ratio indicates better overall profitability and managerial efficiency. It expresses how much the total revenue earned is more than the total expenses incurred.
- A low net profit ratio reveals that the net earning is insufficient and the profitability and managerial efficiency are not up to the mark.
- If a firm has a low net profit ratio in spite of having a high gross profit ratio, it seems that it has excessive indirect expenses on which it has not been able to enforce control.

Operating Profit Ratio

Operating Profit/Net Sales	Operating profit=gross Profit- Operating Expenses(office exp, selling and distribution)= Net Profit+ non-operating(loss on sale of fixed asset, interest) expenses-non-operating incomes(interest received, dividend received)	absent

Significance:

- A high operating profit ratio is the indicator of good profitability and efficient managerial ability.
- A low operating profit ratio (less than the industry standard) shows an alarming situation of the firm because in such a case both the profitability and managerial ability of the firm are below the expected level.
- A low operating profit ratio along with a high net profit ratio reveal more dependence of the firm on non-operating income. It is not a healthy sign of the firms' business policy.

Operating /operating cost ratio

Formula	Factors	Ideal norm
Operating cost/net sales	Operating cost= cost of goods sold + operating expenses Cost of goods sold+ opening stock+ purchases+ direct exp- closing stock	absent

Significance:

- A low operating ratio indicates that the firm has more surplus in its hand alter meeting operating costs. This surplus can be used for payment of tax, payment of dividend, transfer to reserve, etc.
- A low operating ratio is, therefore, an indicator of high profitability and good efficiency.
- A very high operating ratio reveals poor surplus available to the firm after meeting operating costs. It is not favourable to the concern because of a lower profitability and poor efficiency of controlling costs.

Profit volume ratio / contribution sales ratio

Contribution/sales	Contribution=sales – variable cost	Absent

Significance

- Indicator of Profitability in marginal costing.

Note:- Above ratios are expressed in percentage.

2.CAPITAL STRUCTURE RATIOS

Indicator of long-term solvency

Formula	Factors	Ideal norm
Debt - Equity ratio		
Debt/Equity	See note below	2:1

Significance:

- A too high debt equity ratio reveals more investment of loan capital than equity capital in meeting the requirement of finance of the firm. This situation is highly risky because of a higher claim of the outsiders to the firm. Moreover, the greater the loan, the higher is the fixed interest burden which the firm must pay even if it earns insufficient profit. It is true that debt capital is more risky, but at the same time it is considered cheaper than the equity capital. So more use of debt than equity undoubtedly increases the profitability of the firm. It is apparent that the higher the debt equity ratio, the more is the risk and so also the profitability. A high debt equity ratio is always favorable to the shareholders.
- A comparatively, low debt-equity ratio than the :deal norm indicates more use of equity capital than debt capital. The lower the debt, the lower the interest and repayment. burden of the firm. So firm having a low debt bears a low financial risk. But the use of costly equity capital than comparatively cheaper debt capital reduces the profitability of the firm.

Formula	Factors	Ideal norm
Proprietary ratio/Net worth ratio		
Proprietors fund/Total assets	See note below.	1:3

Significance:

- A high proprietary ratio indicates more use of proprietors funds in acquiring total assets of the firm. This situation shows a favorable long-term solvency and a satisfactory financial stability of the firm. So a high proprietary ratio is favorable to the long-term creditors and investors.
- A proprietary ratio below the ideal norm indicates less use of proprietors' fund and more use of debt funds in financing the assets structure of the firm. This situation speaks of the high risk, poor solvency and unstable financial position of the firm and so obviously discourages the long-term creditors and investors.
- If the proprietary ratio is too high it indicates unwillingness of the firm to use more debt capital.

Formula	Factors	Ideal norm
Capital gearing ratio		
(Preference capital + debt)/Equity shareholders fund Or, Fixed income bearing fund/variable income bearing fund	See note below	absent

Significance:

- a highly geared company (a company having a high capital gearing ratio) runs with more risk and a lowly geared company (a company having a low capital gearing ratio) bears a low risk, it means that a high gear Is high- risky and vice versa.
- The state of high gearing is favorable for taking advantage of trading on equity'. In inflationary situation high gearing is effective because at this time the increased income helps to bear the fixed interest burden.
- In a deflationary market situation low gearing is more effective because the low income earned during deflationary. period is not sufficient to bear huge interest burden.
- The management must try to draw up a perfect balance in the use of risky capital and non-risky capital. A balanced capital structure is reflected upon a moderate capital gearing ratio. it is that situation which is neither too risky nor too conservative.

Formula	Factors	Ideal norm
Fixed Assets- Net-worth ratio		
Fixed assets less depreciation /Net Worth	See note below	Absent

Significance:

- **A fixed assets to net worth ratio of more than one reveals that in financing fixed assets along with equity shareholders' fund, debt capital has also been used. On the other hand if this ratio is less than one it explains that fixed have been financed entirely by net worth and a portion of net worth was also used to finance current assets.**
- **A high fixed assets to net worth ratio speaks of the stable financial position and weak long-term solvency of the firm because it indicates more reliance on debt capital in financing fixed assets**
- **A low fixed assets to net worth ratio indicates unstable financial position.**

Debt to total fund

Debt /Total fund * 100	**See note below**	**67%**

Significance

- **Indicator of use of external funds.**

Equity to Total fund

Equity/Total fund	**See note below**	**33%**

Significance:

Indicates long term solvency , mode of financing and extent of own funds used in operations.

Assets-Proprietorship Ratio

Total assets excluding fictitious assets/Proprietors fund	**See note below**	**Absent**

Significance

- **A low assets-proprietorship ratio is an indicator of using more equity capital than debt capital in financing the assets. It focuses on the satisfactory financial base capable of repaying the debts and a stable financial position.**
- **A high assets-proprietorship ratio reveals that the firm is dependent mostly on debt capital so far financing of assets is concerned. Such higher dependence on debt, does- not ensure a good safety of inventors' fund.**

Fixed Assets-Proprietorship Ratio

Fixed Assets / Proprietors fund	**See note below**	**Absent**

Current Assets-Proprietorship Ratio

Current assets/Proprietors fund	**See note below**	**Absent**

Significance

- **If fixed assets-proprietorship ratio is higher than the current assets –proprietorship ratio it is apparent that the higher proportion of fixed assets has been financed by proprietors' fund. More investment of proprietors' fund in fixed assets ensures safety of outsiders' fund and indicates stable financial policy of the firm.**
- **If the current assets-proprietorship ratio is more than the fixed assets- proprietorship ratio it is implied that the greater proportion of proprietary capital has been invested in working capital than fixed assets Such a situation a situation indicates poor solvency and unstable financial position of the firm.**

Note:- definition of the terms used in capital structure ratio above.

Term	Alternative term	Formula for computation
Debt	**Borrowed funds or loan funds**	**Debentures + Long term loans fund banks etc.**
Equity	**Net worth/shareholders fund/proprietors fund/own fund/owners fund**	**Equity share capital + Pref. share capital+ Reserves and surplus less miscellaneous expenses and accumulated losses.**
Equity shareholders fund	**-**	**Equity – Preference share capital**

Total funds	**Long term funds / capital employed / investment**	**Debt +Equity (a) + (b)(Liability route)** **Fixed assets + net working capital (Assets route)**

3.COVERAGE RATIOS

Ability to serve fixed liabilities

Formula	Factors	Ideal norm
Interest Coverage Ratio		
EBIT/Interest	Earning before interest and tax Interest on debentures and loan	Greater than 1

Significance:

- The earning before interest and tax and the operating profit are same. So the interest coverage ratio measures as to how many times the interest burden of the firm is covered by the operating profit of the firm.
- A higher interest coverage ratio indicates better debt servicing capacity. It is beneficial from the viewpoints of both the firm and the lenders. From the viewpoint of the firm it is beneficial because it indicates more shock absorbing capacity in case of lower profit and the reduced risk of default in interest payment. From the lenders' viewpoint it is welcome because it indicates steady return on investment.
- A low interest coverage ratio reveals that the lenders have a low safety of return on their investment, it is also unfavorable to the firm because in such case the firm's profitability in relation to its interest payment commitment is low and it is not in a position to take recourse to further debt financing in case of any need.

Formula	Factors	Ideal norm
Debt Service Coverage Ratio		
Earning for debt service /(Interest +Installment of Loan Due for Repayment)	Earning for debt service = Profit after Tax + Interest + Depreciation+ non operating expenses – non-operating income	2 to 3 times

Significance:

- A higher debt service ratio is favorable both to the firm and the lenders. From the firm's viewpoint it indicates the sound capacity to repay interest as well as installment due in time. It also shows that the firm has the ability to serve more debt. On the other hand from the lenders' viewpoint it indicates a high safety and minimum risk of getting interest and principal repayment.
- A low debt service ratio indicates that the firm is not in a satisfactory position to repay the interest and principal to the lenders. It goes against the firm's goodwill and refrains it from taking further loan. A low debt service ratio is also not a welcoming feature to the lenders because it indicates more risk in getting interest and principal in time.

Formula	Factors	Ideal norm
Preference Dividend Coverage Ratio		
(Net Profit after Interest and Tax or PAT) / Preference Dividend	---	absent

Significance:

- The higher the preference dividend coverage ratio the more is the scope of higher dividend for the equity shareholders because equity dividend is paid from the surplus profit remaining after paying preference dividend. If this ratio is high that also indicates more surety for the preference shareholders in getting dividend.
- A low preference dividend coverage reveals that the preference shareholders' claim of dividend is not much secured. So it is against the interest of the preference shareholders. A low preference dividend coverage indicates a low return for equity shareholders too.

Formula	Factors	Ideal norm
Equity Dividend Coverage Ratio		
(Net Profit after Interest, Tax and Preference Dividend) / Equity Dividend	--	absent

Significance:

- The higher the equity dividend coverage ratio the more is the security of the equity shareholders to get dividend. It also indicates good financial stability of the firm because the firm is in a position to pay equity dividend after meeting all fixed burdens and tax liability.
- A low equity- dividend coverage ratio is against the interest of the equity shareholders as it reduces the security of getting dividend by them.

4.ACTIVITY /TURNOVER /PERFORMANCE RATIOS

Formula	Factors	Ideal norm
Stock or Inventory Turnover or Velocity		

If expressed in times = Cost of Goods Sold or Net Sales / Average Stock If expressed in months = (Average Stock x 12) / Cost of Goods Sold or Net Sales If expressed in number of days = (Average Stock x 365) / Cost of Goods Sold or Net Sales	Average Stock = (Opening Stock + Closing Stock) / 2 [If it is not possible to ascertain the Cost of Goods Sold, the net sales may be used for the computation of this ratio.] Cost of goods sold= opening stock + purchases- closing stock	absent

Significance:

- It shows the rapidity with which the inventory transforms into receivables through sales.
- A high inventory turnover ratio implies low inventory level and quick conversion of inventory into sales. It is the sign of efficient inventory management.
- A low inventory turnover ratio indicates maintenance of a high level of inventory and slow rotation of inventory in the operating cycle process. It is suggestive of poor inventory management.

Important Point to Note :
The Inventory Turnover Ratio may be used to find out the number of days of inventory holding as follows: Number of days of Inventory Holding = 365 (No. of days in a year) / (Inventory Turnover Ratio)

Debtors or Receivables Turnover/ Debtors velocity

If expressed in times = Credit Sales / Average Debtors or Average Receivables If expressed in months = (Average Debtors or Average Receivables x 12) / Credit Sales If expressed in number of days=(Average Debtors or Average Receivables x 365) / Credit Sales=365/DTR	Average Debtors = (Opening Debtors + Closing Debtors) / 2 Average Receivables = (Opening Receivables + Closing Receivables)/ 2 Here, Receivables stand for the summation of Debtors and Bills Receivable.	Absent

Significance:

- A high debtors turnover in comparison to the industry standard indicates quick collection from debtors i.e. short credit period, quick recycling of working capital and efficiency in debt management.
- A low debtors turnover reveals slow realization from debtors i.e. long credit period, slow recycling of working capital and inefficiency in receivables management.

Creditors or Payables Turnover/ velocity

If expressed in times = Credit Purchases /Average Creditors or Average Payables If expressed in months = (Average Creditors or Average Payables x 12) / Credit Purchase. If expressed in number of days =(Average Creditors or Average Payables x365) /Credit Purchase = 365/CTR	Average Creditors = (Opening Creditors + Closing Creditors)/2+(opening B/P+ cl. B/P)/2 ---	absent

Significance:

- It indicates speed or velocity of creditors.

Fixed Assets Turnover

Cost of Goods Sold or Net Sales / Net Fixed Assets	If it is not possible to ascertain the cost of goods sold this ratio may be computed on the basis of net sales.	absent

Significance:

- A high fixed assets turnover ratio is an indicator of efficient utilization of fixed assets in generating sales. It reveals that use of less fixed assets made possible higher generation of sales.

- A low fixed assets turnover ratio indicates inefficient managerial ability in utilization of fixed assets because it reveals that use of more fixed assets resulted in lower generation of sales.

Current Assets Turnover

Cost of Goods Sold or Net Sales / Total Current Assets	If the cost of goods sold cannot be ascertained this ratio may be computed on the basis of net sales	absent

Significance:

- If this ratio is high it indicates an efficient utilization of current assets in generating sales. It reveals that use of less fixed assets has generated more sales.
- If this ratio is low it is indicative of inefficiency in working capital management. It reveals that use of more current assets resulted in lower generation of sales.
- A too high or too low current assets turnover is not a welcoming feature of a firm's management. If this ratio is nearer to the average or standard followed in the industry it is considered as an indicator of an efficient activity level of the firm.

Capital Turnover Ratio

Cost of Goods Sold or Net Sales / Net Capital Employed	If the cost of goods sold cannot be ascertained the net sales may be accepted as the numerator	absent

Significance:

- A high capital turnover indicates an efficient management of the capital employed in the firm. It reveals that lower employment of capital has resulted in higher achievement of sales. This situation is helpful for increased profitability. It is an indicator of future growth potentiality.
- If this ratio is low it expresses the inefficient management of capital. In such a situation more use of capital results in a comparatively lower generation of sales. A continuously falling capital turnover ratio is an indicator of deteriorating business growth.

Raw Material Turnover ratio

Cost of raw material consumed/Average stock of raw material	Raw material consumed= opening stock of raw material + purchase- closing stock of raw material Average stock of raw material=(opening stock of raw material + closing stock of raw material)/2	Absent

Significance:

- Indicates how fast /regularly raw material are used in production

WIP Turnover Ratio

Factory cost/Average stock of WIP	Factory cost= materials consumed + direct wages+ direct expenses+ production overhead Average stock WIP= (Opening stock of WIP+ Closing stock of WIP)/2	Absent

Significance:

Indicates the WIP movement /production cycle.

5.OVERALL RETURN RATIO /OWNERS POINT OF VIEW

Formula	Factors	Ideal norm
Return on Capital Employed/Return on Investment		
Pre-tax ROCE= EBIT/Capital employed Post–tax ROCE= (Earning after tax+ interest)/Capital employed	Capital employed=Investment= Equity + Debt	absent
Significance: ➢ This ratio is a real test of the profitability and managerial efficiency. The higher the return on capital employed the higher is the profitability and the sound is the managerial ability. From the viewpoint of shareholders and the management a high return on capital employed is always favorable. ➢ A low return on capital employed in comparison to the industry standard reveals that the firm has not been able to earn a reasonable profit. It also explains that the managerial skill is not sound enough to increase the profitability. A low return on capital employed is against the interest of the shareholders and management. ➢ If the cost of long-term borrowing is lower than the return on capital employed, return to shareholders would increase. ➢ A high return on capital employed achieved for a few consecutive years indicates that the firm has a stable financial position and has good future prospect.		
Return on Proprietors' Funds /Equity/Net worth		
Pre –tax ROE= EBT/Equity Post –tax ROE= EAT/Equity	See above	absent
Significance:		

- Indicates profitability of Equity funds/owners funds invested in the business.

Return on Equity Shareholders' fund

(Net Income after Interest and Tax and preference dividend / Equity shareholders fund	Equity shareholders fund=Equity Share Capital + Reserves & Surplus - Fictitious Assets	absent

Significance:

- Indicate earning rate on equity shareholders fund.

Return on Total Assets

Pre –tax ROA= EBT/ Average total assets Post –tax ROA= EAT/ Average total assets	Average total assets= ½ of opening and closing of total assets/fixed assets/tangible assets	absent

Significance:

- It is a measure to evaluate the performance and profitability of the firm. It relates the profits to the size of the firm which is measured in terms of the assets under the firm's possession.
- A high return on total assets is an indicator of high profitability and a good overall efficiency. Reversely a low return on total assets indicates low profitability on assets employed and it speaks of poor managerial efficiency.
- If the total assets of a firm increase without any corresponding increase in its operating profit, the return on total assets will come down. It reveals that the increase in investment has not resulted in the welfare of the owners.

Price Earning Ratio

Market Price per Share / Earnings per Share	--	absent

Significance:

- A high price earning ratio indicates either a fall in earning per share or an increase in market price per share. A high price earning ratio resulting from increased market price per share is beneficial to the shareholders. It indicates high managerial efficiency, high profitability and good market reputation.
- A low price earning ratio not caused by an increased earning indicates reduced market price per share. It also reveals a low level of managerial efficiency and profitability. It is against the interest of the shareholders.
- If the low price earning ratio is caused by an increased earning per share it does not indicate an unfavourable situation for the shareholders.

Dividend Yield Ratio

Dividend per Share / Market Price per Share	-	absent

Significance:

- It makes an analysis of the return on equity shares not on the basis of the face value of the shares but on their market value. So it reflects on the true rate of return available to the equity shareholders.
- The higher the dividend yield ratio the more is the return for equity shareholders. It indicates the high rate of profit earned by the company.
- If this ratio is low it indicates a low return on equity share capital and a low profitability.
- If the market price of the equity shares is too high the dividend yield ratio may be considerably low. In such case, of course, the return of the equity shareholders may not be too low. So a low dividend yield ratio in a situation of very high market price of equity share is not against the interest of the equity shareholders.

Earning Yield Ratio

❖ Earning per Share / Market Price per Share	--	absent

Dividend Payout Ratio		
Dividend per Share / Earning per Share **or** **Cash Equity Dividend Paid / Profit available for Equity Shareholders**	--	**absent**

Significance:

- A **high** dividend payout ratio **indicates** that the **greater** portion of **profit available** to the equity shareholders has been distributed while a smaller portion has been retained. The shareholders like to get more cash dividend, so a high dividend payout ratio is favorable to them.
- A **low** dividend payout ratio reveals that the **smaller portion** of **profit** due to the **equity** shareholders has been paid in cash, while the greater portion has been retained. The shareholders, keen to get cash dividend, do not like this position.

Dividend per share		
Total Equity dividend/Number of equity shares	**Total equity dividend=profits distributed to equityholders**	**absent**

Significance:

Profit distributed per equity share

Book Value per share		
Net assets available for equity shareholders/Number of equity shares	**Net assets available for equity shareholders=Net worth –Preference capital**	**absent**

Significance:

Basis of valuation of shares based on book values

Expense Ratio or Specific Expense Ratio		
Particular Expenses / Net Sales	**Manufacturing expenses or office an administration expenses, or selling expenses.**	**absent**

Significance:

- From the expense or specific expense ratios it is possible for an **analyst** to understand in a better way the **behaviour** and variability of different **expense** items for a given change in the sales.
- The **lower** be these ratios, the **higher** is the **profitability** and the better is the managerial efficiency.
- The **higher** expense ratios are **not favourable** for the firm because they indicate lower profitability and poor expertise of controlling costs.

Material Consumed Ratio		
Cost of Materials Consumed / Cost of Production	-	**absent**

Significance:

- A **higher** material consumed ratio comparison to the standard acceptable in the industry indicates that a **greater** proportion of total cost is spent for **material**. It is the indicator of managerial inefficiency and a possible lower profitability.
- If this ratio is **lower** than the industry standard it indicates that **material** cost as a part of total cost is **lower** and the **wages** and overhead cost are **higher**. From the viewpoint of managerial skill and profitability it. is always desirable not to have a very high material consumed ratio.