Stock turnover ratio

The stock turnover ratio is a measurement of the number of times your stock ‘turned over’ or was sold in the financial year. This ratio gives you an indication of the volume of activity in your business. If stock levels are steady, an increasing stock turnover rate means you are selling more, a decreasing rate means you are selling less.

This ratio is calculated by dividing cost of goods sold by the average stock held.

\[
\text{Stock turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock at cost}}
\]

The cost of goods sold figure is the total cost of items sold throughout the trading period. The average stock at cost figure is the average of the opening and closing stock amounts.

Days’ stock on hand ratio

This ratio would tell you how long your current stock level would last if you stopped buying new stock.

The formula for the ratio is as follows.

\[
\text{Days’ stock on hand ratio} = \frac{\text{Stock on hand}}{\text{Cost of goods sold}} \times 365 \text{ days}
\]

A high figure would indicate a low stock turnover, whereas a low days ‘stock on hand’ ratio would indicate high stock turnover and general good stock management.

Debtors’ turnover ratio

This ratio is calculated as follows.

\[
\text{Debtors’ turnover ratio} = \frac{\text{Trade debtors}}{\text{Total credit sales}} \times 365 \text{ days}
\]
Financial ratios

This calculation results in the number of days’ sales represented by outstanding debts. It is a means of measuring the effectiveness of your credit control policy and should alert you to the importance of prompt debt collection. It tells you how many days on average it takes your business to collect an account. If your terms of credit are 30 days and your debtors’ turnover calculation has resulted in 45 days then your customers are not paying their bills on time. Steps should be taken to correct this problem.

**Debtors to sales ratio**

\[
\text{Debtors to sales ratio} = \frac{\text{Debtors}}{\text{Sales for the month}}
\]

This ratio looks at changes in your debtors on a *monthly basis*. It quickly alerts you to any cash flow problems arising out of problems with your business’ debtors control.