



Benchmark your company's financial performance **Comparative analysis highlights strengths and weaknesses**

If you're a business owner contemplating a sale, or a buyer looking to acquire a company, comparing financial performance to industry peers can be a useful exercise. Fortunately, the ready availability of comparative data makes analyzing various financial performance metrics for your business or target company fairly simple.

Advantages of comparative financial analysis

Sellers' comparative analysis provides insight into historic performance compared to industry averages. This can help highlight financial concerns owners need to address prior to selling their business.

Buyers — particularly those with little experience with the target business or industry — can use income statements and balance sheets to identify the relative strengths and weaknesses of the target. Ultimately, this can help them determine whether the acquisition is worth the costs involved in acquiring it.

Income statement comparisons may identify specific categories of expenses that need to be reduced. If, for example, raw material costs are out of line, a potential buyer might want to review existing vendor relationships.

Balance sheet items such as accounts receivable turnover (the average days to collection) and inventory turnover (the average time items are stored in inventory) can also provide meaningful insight. Improvements in these areas might mean a reduction in working capital requirements and, thus, reduce line-of-credit costs.

Sources of industry data

There are several sources of comparative company data. Which source provides you with the most meaningful information depends largely on the industry and size of your company.

RMA Annual Statement Studies. These guides from the nonprofit Risk Management Association publish balance sheets and income statements, plus 16 financial ratios, for each of 330 standard industrial classification (SIC) groups. Each of these groups is broken into four size categories, based on total assets and sales. Comparative historical data for the prior three years is shown for each financial ratio.

Dun & Bradstreet Key Business Ratios. Similar to the RMA studies, this annual report calculates 14 ratios for each SIC group. Companies are broken into three categories, based on total sales. For each category within an SIC group, the median, upper and lower quartile values are shown for each ratio.

Almanac of Business and Industrial Financial Ratios. This publication uses data compiled from corporate federal tax returns. It is segregated into more than 175 business and professional practice groups (such as physician and law practices) — slightly more than half that of the RMA publications. Each group is further broken down by asset size.

Financial Studies of the Small Business. Published by Financial Research Associates, this study is a compilation of approximately 25,000 financial statements submitted by more than 1,000 independent accounting firms. *Financial Studies* focuses on small businesses with assets of \$500,000 or less and includes over 50 types of small businesses and professional practice groups.

These resources are generally available in public libraries, and both printed copies and CD-ROMs can be purchased from the publishers. Other potential sources of industry data include trade association publications and periodicals, and Standard & Poor's Industry Surveys.

Ratios to know

Comparing the financial ratios of your business or target company with industry averages can identify both areas for improvement and sources of concern. Look at ratios relating to the following major areas:

Profitability. This includes both income statement profitability and rates of return, such as return on equity or return on assets. You may look at profitability measures such as net income, EBIT (earnings before interest and taxes) or EBITDA (earnings before interest, taxes, depreciation and amortization).

Liquidity measures. The two short-term liquidity ratios are current ratio (current assets divided by current liabilities) and quick ratio (cash plus receivables, divided by current liabilities). These measures may indicate whether working capital is inadequate or excessive.

Leverage. The primary balance sheet leverage ratios are debt to equity, and equity to total assets. If the company's leverage ratio is below industry averages, it may suggest unused borrowing power.

Utilization. Utilization ratios measure how efficiently assets are being deployed. Typical ratios include accounts receivable turnover, inventory turnover and asset turnover (sales divided by assets).

Raise your company's financial profile

Understanding how a company is performing relative to its peer group should be important to any business owner or buyer. Even if you aren't contemplating a sale, regularly benchmarking your company's financial statements — perhaps as part of the annual accounting review — is a valuable exercise.