

III Activity / Turnover Ratios

1. Stock (Inventory) Turnover Ratio
$$= \frac{\text{Cost of Goods sold}}{\text{Average stock.}}$$

where Avg stock. =
$$\frac{\text{Op. stock} + \text{Cl. stock}}{2}$$

This ratio measures how fast the stock is moving through the firm and generating sales.

Higher the ratio, the more efficient management of inventories and vice versa.

2. Debtors' / Receivable Turnover Ratio
$$= \frac{\text{Net credit sales}}{\text{Average Accounts Receivables}}$$

where ^{Avg.} A/c Receivable:

$$= \frac{(\text{Op Debtors} + \text{Op. B/R}) + (\text{Cl. Debtors} + \text{Cl. B/R})}{2}$$

* In this ratio meaning of debtors is considered account receivable i.e.
Debtors + Bills Receivable

* This ratio indicates ~~strong~~ economy and efficiency in the collection of amount due from debtors.

* Higher the ratio, better it is since it indicates that debts are being collected more quickly.

3. Creditors' / Payable Turnover Ratio

$$= \frac{\text{Net credit purchases}}{\text{Average payables}}$$

$$\text{where, avg. payables} = \frac{\left(\begin{array}{l} \text{op. creditors} \\ + \text{op B/P} \end{array} \right) + \left(\begin{array}{l} \text{U. creditors} \\ + \text{U. B/P} \end{array} \right)}{2}$$

It indicates the no. of times the creditors are turned over in relation to purchases.

A higher turnover ratio or shorter payment period shows the availability of less credit ~~avg~~ or yearly payments.

4. Working Capital Turnover Ratio
$$= \frac{\text{Net sales or Cost of goods sold}}{\text{Net working capital}}$$

Net Working Capital = Current Assets - Current Liab.

- * This ratio shows the no. of times the working capital has been employed in the process of carrying on of business.
- * Higher the ratio, better the efficiency in the utilisation of working capital.
- * $\text{COGS} = \text{Sales} - \text{Gross profit}$
OR
$$= \text{OP stock} + \text{purchases} + \text{direct expenses} - \text{C. stock}$$

ACTIVITY RATIOS

Q1. From the following data, calculate the Inventory Turnover Ratio:

Cost of Goods sold Rs. 300 000

Purchases Rs. 330 000

opening stock Rs. 60 000

Q2. Calculate the debtors turnover ratio from the following

• Closing Debtors Rs. 40 000

• Credit sales being 25% of Cash Sales

• Excess of closing Debtors over opening Debtors is Rs. 20 000

• Total Sales are worth Rs. 150 000

Q3. Working Capital Rs. 250 000; cost of Goods sold Rs. 10 00 000; Gross profit on sales 20%. Calculate the Working Capital Turnover Ratio from the given information.

Ans. ① 4 Times

② 1 Time

③ 5 Times