

## 9.15: Financial Goals

### Learning Objectives

- Identify the financial goals of the business

Although it may seem obvious, the first financial goal of a business is to make money, but that really isn't specific enough. The goal is to make enough money to cover all expenses and grow the business as well. This means that revenue must cover the cost of goods sold, operating expenses, and taxes, while also having some portion left over to support investment back in the business to fund new or special initiatives.

This requires that retailers understand profits as a percentage of sales (profit margin = profit / sales revenue), looking to increase it in future periods through efficient management of the business.

As we continue our learning, we will see how to use financial calculations and ratios to judge performance. In this way, they can be used a management tools to assess operations and identify areas for improvement. Some important ones to consider are operating profit margin, asset turnover, and return on assets.

### Operating Profit Margin

Operating profit margin is sometimes referred to as earnings before interest, taxes, and depreciation. It is the measure of the profitability from business operations, and a good indicator of future profitability. This information can be gathered from the company's profit and loss statement and is calculated as operating margin = operating earnings / revenue, where operating earnings = revenue – cost of goods sold (COGS), labor, and general and administrative expenses.

For example, let's consider a grocery store, FreshEatz, and their financials:

• Revenue-	\$15,000,000.00
• COGS-	-12,000,000.00
• Labor-	-1,800,000.00
• General & Admin-	-900,000.00
• Profitb	\$300,000.00

In this example, COGS, labor, and general and admin combine as operating expenses (\$14,700,000), which are subtracted from the revenue (\$15,000,000 – \$14,700,000 = \$300,000).

Thus, the operating margin is \$300,000 / \$15,000,000 or 2%.

### Asset Turn-over

Asset turnover, or turnover rate, is a ratio of how many times during a selling season assets are turned over, or used.

In other words, it calculates how many sales dollars are generated for each dollar invested in assets. The formula is revenue / net assets. Again, let's return to the example of FreshEatz, whose asset turnover is 1.5 (\$15,000,000 / \$10,000,000).

This means that FreshEatz turns-over their assets 1 ½ during the selling season or period we're reviewing. This alone isn't telling. But, it potentially shares a great deal when compared to historical data or to competitors.

For example, if Goodness Great Tastes, a rival grocer in-market, has comparable revenue at \$15,000,000 and assets of \$15,000,000, their asset turn-over would be 1.0 (\$15,000,000 / \$15,000,000). This would indicate that Goodness Great Tastes doesn't deploy its assets to generate revenue as efficiently as FreshEatz.

### Return on Assets

One way a firm can reflect its efficiency is return on assets (ROA), which is how much income is produced by its use of assets. Again, for a retail business, assets are inventory available for sale and the dollars generated by sales. Again, consider FreshEatz and Goodness Great Tastes, for an example. Let's assume each has profits of \$300,000. Thus, it might appear that they are performing equally well.

But we know from earlier that they have different levels of assets. Thus, if we look closer, we see:

- FreshEatz- \$10,000,000 in assets
- Goodness Great Tastes- \$15,000,000 in assets.

In this scenario, FreshEatz would be considered more profitable, since they were able to generate more profit on a smaller value of assets ( $\$300,000 / \$10,000,000 = 3\%$  for FreshEatz vs.  $\$300,000 / \$15,000,000 = 2\%$  for Goodness Great Tastes). This means that every dollar in assets returns an extra \$.03 for FreshEatz and only \$.02 for Goodness Great Tastes. While that difference may appear modest, it reflects how well FreshEatz is deploying their assets to generate profit, compared to Goodness Great Tastes.

The retailer's ROA can also be calculated by multiplying the operating profit margin by asset turnover. Let's check to see whether this would work for FreshEatz, given our previous work.

- Operating Profit Margin- 2.0%
- Asset Turn-over- 1.5

Thus,  $2.0\% \times 1.5 = 3.0\%$ , which matches the previous calculation. Simply, you should know that there are different approaches to determining the ROA for a firm.

Ultimately, it's the use of ratios and calculations like the ones described above that can serve as helpful management tools for a firm, identifying areas that can help improve long-term profitability. Financial planning like this is the foundation of retail management, an important component of the retail strategic plan. Based on past performance, balanced by industry benchmarks and current trends, financial planning has an eye toward improved performance.

### ? Practice Questions

<https://assessments.lumenlearning.co...essments/9232>

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