FINANCIAL DECISION MAKING

'Healthy habits toolkit'

Start >

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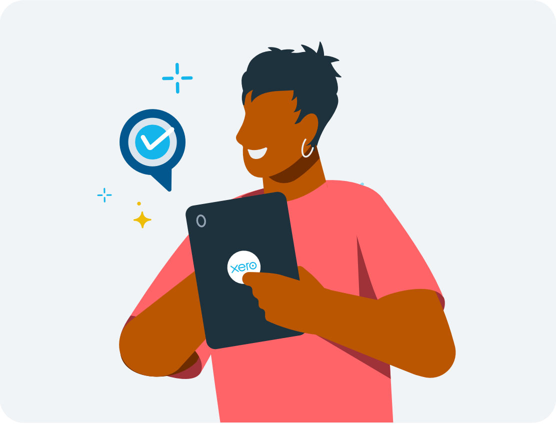
FINANCIAL FITNESS

WELCOME

Welcome to the 'Healthy habits toolkit'. We'll guide you, step by step, through small business finance with bite-sized content that helps you understand YOUR numbers and build financial confidence.

Using the toolkit

1. Download the toolkit.
2. Use it on any device or print it off if you prefer.
3. Work through the activities to build the financial habits, skills and mindsets that will help your business succeed.



Look out for...

Habit builder

Activities that help you track your business's financial health and make informed decisions.

Mindset

Activities that help you build the mindsets you need to stay focused and tackle challenges head-on.

Tell me more

Additional resources and real-world examples from other small business owners.

Reaching out for support

If you need support or advice along the way:

- Talk to an accountant or bookkeeper for financial advice and help with planning your next steps. If you don't have one, you can apply for free mentoring through the **Xero For Good Ambassador Program**
- Explore **resources from the Australian Government, covering financial management, cash flow templates, and business owner mental health/ wellbeing**
- Access **free small business guides from the Australian Taxation Office**
- Check out our **frequently asked questions**
- Access **services to help if you are experiencing financial difficulties**

If you are reading a printed version of this toolkit, you can find the full URLs for all the internet pages linked above in the **appendix** at the end.

The information provided is for general educational purposes only and should not be considered financial, legal, or tax advice. Please consult with a professional before making financial decisions.

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FINANCIAL DECISION MAKING

In this topic, you'll build the skills, knowledge and mindset you need so you can make good financial decisions that set you up for success.

You'll explore how your numbers can inform your decisions, the key financial ratios you need to know, learn how to create a simple dashboard to monitor your ratios and set goals for improving your business.

Work your way through the 'Healthy habits toolkit' and take your first steps to financial confidence.

Work your way through the 'Healthy habits toolkit' and take your first steps to financial confidence.

Choose where to start:

Select any of the five headings below to get started.

More than metrics

The big three

The power of evaluation

Using metrics to guide your decisions

Use the interactive buttons and topic menu to move through the toolkit or scroll down to read the pages in order.

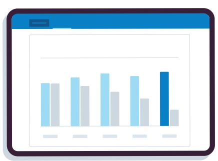
MORE THAN METRICS

Your numbers don't run your business – you do. They are one part of a bigger story that you write with each decision you make for your business.

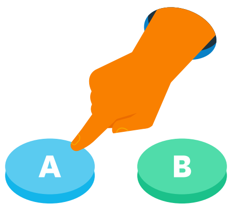
That's where your metrics come in. Making financial decisions without your numbers and metrics means you're just making guesses. When you use your metrics to guide decisions, you're making informed choices that support a stronger, more sustainable business over time.

What do you measure?

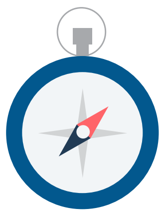
Take a moment to reflect on how you measure your business performance.



What numbers do you check in your business today?



What do you use them for?



How often do you use them to guide a decision?

What other metrics (financial or non-financial) do you already track?

Move your mindset

When you stop thinking about your numbers in isolation, they go from being just tools for reporting and compliance to helping you make better decisions for your business. When you measure your metrics, you can:

1. See what's working
2. Spot risks early
3. Plan for growth or stability

Metrics aren't one-size-fits-all. How often you measure, which metrics you prioritise, and when you use them will vary from business to business and change as your business evolves.

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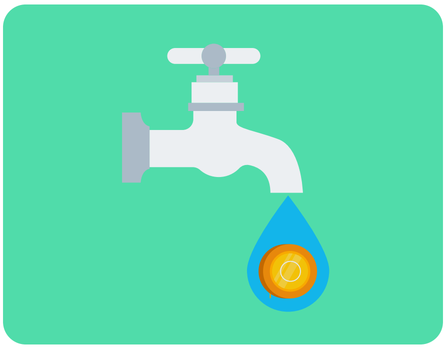
THE BIG THREE

Regularly checking your business's numbers is an integral part of maintaining a healthy business. Working with financial ratios takes these health checks and levels them up, helping take the guesswork out of some key questions you might ask yourself:

- Am I making enough money from sales?
- Can I pay my bills?
- Am I using my resources wisely?
- How stable is my business?

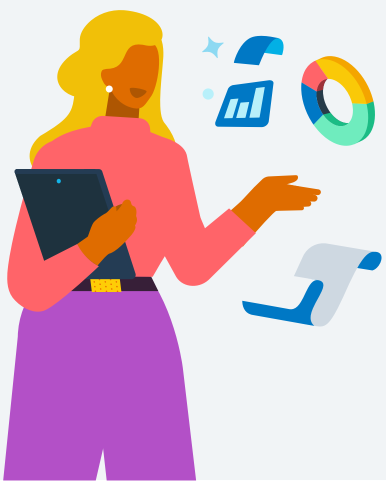
There are three key financial ratios that can guide your decision-making:



Profitability: how much of your sales actually turn into profit.

Liquidity: your ability to pay short-term debts.

Efficiency: how effectively your business manages supplier obligations and customer payments.



Like all your business finances, these ratios are just part of the story.

Once you know how to calculate and use these ratios, you can use them alongside other non-financial indicators (like customer reviews) to make more informed decisions for your business.

They provide clear insights into your financial health and highlight areas where you should focus your attention.

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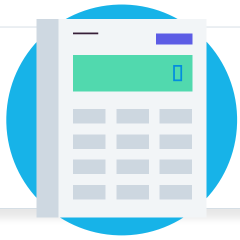
Profitability

Every business needs to make a profit. But how can you tell if your profit is enough for yours?

The most common measure of profitability is the net profit margin.

Net profit ÷ Revenue × 100 = **Net profit margin**



Net profit and revenue can be found in your profit and loss statement (P&L).

Your net profit margin shows how much money you make from every sale. For example, if your business makes $100,00 in sales and has a net profit of $10,000, you can calculate your net profit margin using the formula:

Net profit $10,000 / Revenue $100,000 x 100 = 10%

In other words, you keep $10 in profit for every $100 in sales. The question is, what is a good net profit margin for you?

Net profit vs net profit margin

Take a moment to reflect on how you measure your business performance.

Net profit tells you how much money your business made after expenses.

Net profit margin tells you how efficiently your business turns sales into profit.

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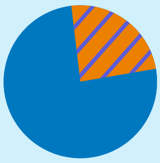
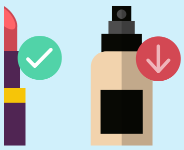
While net profit gives you a dollar amount, net profit margin gives you a percentage. This makes it easier to see how your business is doing, compare your results over time, or compare yourself with other businesses like yours.

In short, net profit margin gives you insight into the health and efficiency of your business, not just the outcome.

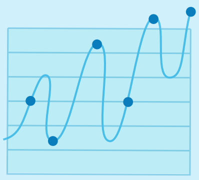
Here's why measuring profitability (net profit margin) matters more than just knowing your net profit:



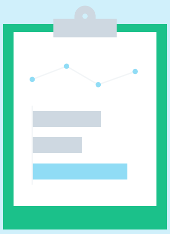
Shows efficiency, not just outcome. Two businesses can have the same net profit but very different net profit margins. For example, a $10,000 profit on $50,000 in sales (20% margin) is far stronger than a $10,000 profit on $200,000 in sales (5% margin).



Allows fair comparison. The percentage measure enables you to compare profitability across products, time periods, or businesses of different sizes.



Reveals trends early. A shrinking net profit margin can signal rising costs or pricing issues, even if the profit dollars still look good.



Informs better decisions. Knowing your net profit margin helps you test what could happen if you raise prices, reduce costs, or change suppliers. It shows how these shifts affect profitability, not just revenue.

Supports strategic growth. A strong margin means your business is scalable – you can grow sales without costs growing at the same pace.

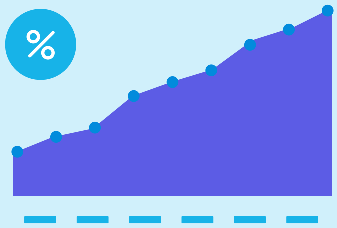
The importance of comparison

To understand if your profitability is good, you need to compare your net profit margin to something. You might compare it to your past results to see if you're improving, to similar businesses to check how you measure up, or to industry benchmarks to understand what's typical.

Ask yourself:

Do similar businesses have a similar net profit margin?

Did your business have a similar net profit margin last year?



What is the industry benchmark for net profit for your type of business?

Once you understand what your net profit margin means for your business, you can think strategically about what to do next.

Improving profitability

To increase your profitability, focus on widening the gap between the cost of making a sale and your selling price. You can do this by increasing your prices or reducing your costs. You might, for example, look for better deals with suppliers or shop around for cheaper ones. Simply selling more isn't the answer – if your costs rise at the same rate as your sales, your profitability won't improve.

Remember: Profit doesn't equal cash.

Check your profitability more frequently when your business is new or undergoes changes, such as expansion or a shift in demand for your product or service.

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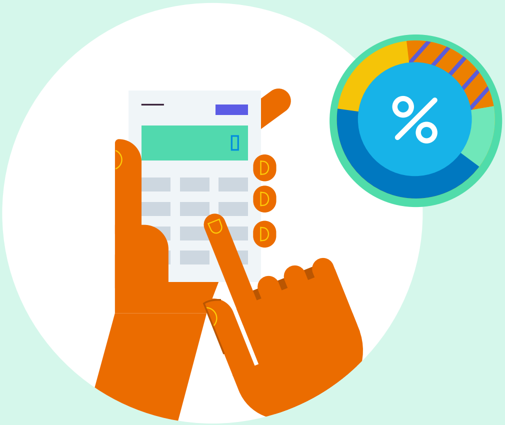
What's your net profit margin?

Have a look at your most recent profit and loss statement.

- Calculate your net profit margin:



Net profit (A) =

Revenue (B) =

Net profit margin (A / B x 100) =

- Is your profitability more or less than expected?
- What indicators are you comparing with to decide?
- What does your current net profit margin mean for your business?

Want to dive deeper into profitability? Check out the guide:

- **What is profitability?**

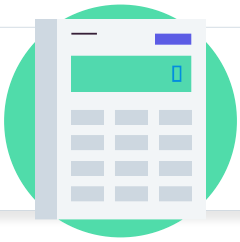
Profitability is a key indicator of your business's long-term financial stability. Regularly monitoring it gives you time to quickly adapt and make improvements before problems arise.

Next

Repurposing the profitability formula

Once you understand how to calculate net profit margin, you can apply a similar approach to other costs in your business. A good example to look at is advertising – especially when thinking about spending more to generate more sales. By comparing your advertising spend to the sales it generates, you can see how your marketing dollars are driving the results you need.

$$\frac{\text{Advertising costs}}{\text{Revenue}} \times 100 = \textbf{Cost percentage of advertising}$$



Example: If you spend $500 on advertising in a month and it generates $2,500 in sales:

$500 / $2,500 × 100 = 20%

This means for every $1 of sales, you're spending 20 cents on advertising. Framed another way, every $5 in sales costs you $1 in advertising.

The right balance between advertising spend and sales will look different for every business. What matters most is whether your advertising is delivering real value for what you spend.

To work that out, you can ask yourself:

Are my sales increasing enough to justify my advertising spend?

Is my advertising attracting the right type of customers?

Could I achieve similar or better results with a different channel or lower spend?

Next >

Liquidity

Being able to pay your short-term debts is essential not only for your business to operate but also to thrive. That's where liquidity comes in. It's your spending power, and there is a simple calculation you need to know. You can find the numbers you need by looking at your balance sheet.

Current ratio

Current assets (Money and assets that can be sold quickly) ÷ Current liabilities (Money owed in the coming 12 months) = **Current ratio** (Liquidity)

Also known as the working capital ratio, this calculation shows you how easily your business can cover its costs over the next 12 months. It looks at assets you'll turn into cash within a year (like money in your bank account, customer invoices you expect to be paid, or stock you plan to sell) and bills you'll need to pay within a year (like supplier bills, short-term loans, credit card payments, rent, or tax bills).

Tell me more about liquidity ratios:

- **What is liquidity?**
- **What is the quick ratio?**
- **Quick vs current ratio**

What does the ratio mean?

Liquidity calculations are shown as a ratio to one. For example, a 2:1 ratio means you have $2 for every $1 in bills you need to pay. This means your business is in a strong position to cover its costs and deal with surprises. As a simple rule, aim for a ratio above 1:1. That means you can pay your bills without stress and have some room to grow.

There isn't a perfect ratio to aim for, but if you understand and watch your ratio, you can make better financial decisions and keep your business stable.

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Using your ratio to guide your decisions

Once you understand your ratio, you can use it to make smart financial decisions.

If your current ratio is high

You're in a strong liquidity position. Instead of leaving your cash idle, think about using your resources more effectively, running your operations more efficiently, and investing to grow your business. Some options to consider include:

- Investing in growing your business or paying off longer-term debts faster
- Expanding your products or services while the risk is low
- Maximising the value of your cash by moving it to a higher interest account
- Applying for credit with confidence, showing creditors you have the liquidity to repay the debt

If your current ratio is low

You may struggle to cover upcoming bills. If your goal is to improve liquidity and manage short-term obligations, some options to consider include:

- Focusing on collecting invoices faster to bring more cash in quickly
- Spending less or delaying short-term expenses, without harming how your business runs
- Building a buffer to prepare for seasonal or unexpected costs
- Increasing sales or selling assets you no longer need to boost your available cash

When you understand your liquidity, you can use your resources well, avoid spending too much or growing too quickly, and get the most from the assets and cash you already have. Find out more in our helpful article, **What are liquidity ratios?**

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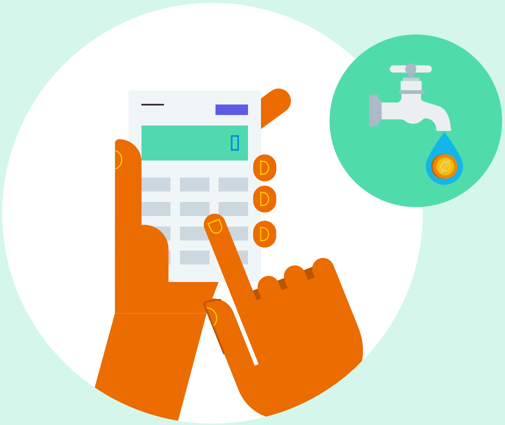
What's your liquidity?

Have a look at your balance sheet.

- Calculate your current ratio:



Current assets (A) =

Current liabilities (B) =

Current ratio (A / B) =

- Interpret your results
  - Take note of what your current ratio means to you. Are you ok with your current liquidity?
  - What might it help or prevent you from doing?
  - What will you do now?

What does your current ratio mean for your business? Note down your initial thoughts.

Next

Efficiency

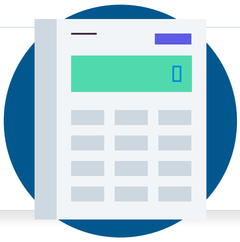
Efficiency isn't just how fast you work; it's how smoothly money flows in and out of your business. Think of it like your circulation system: if money gets stuck in slow-paying customers, unpaid bills or unsold stock, your business feels the pressure. The more efficiently you can manage your cash flow (including supplier obligations and debts), the healthier your business will be.

To calculate this, you'll need your income (from your P&L) and your receivables (from your balance sheet).

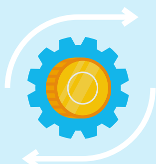
Measuring receivable days

One of the key ways to check efficiency is to look at your receivable days (sometimes called debtor days). This shows, on average, how long it takes your customers to pay you. It's important because it changes how much cash you have at hand.

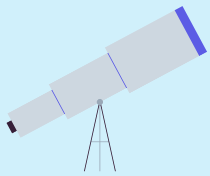
Total value of receivables ÷ Total income × 365 = **Total days to get paid**



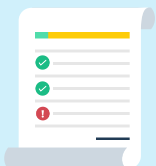
Knowing your receivable days can help you with:



Cash flow management: The faster your customers pay, the more cash you have available to cover bills, invest, or take on opportunities.



Planning and stability: Knowing how long it typically takes to get paid helps you forecast cash needs and avoid unnecessary short-term borrowing.



Customer management: Long receivable days can indicate that certain customers consistently pay late, which may require better payment terms or credit control processes.

Efficiency check: It shows how well you handle invoicing, billing and credit control.

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Calculate your receivable days

Value of receivables (A) =

Total income (B) =

Receivable days (A / B x 365) =

- Consider: What are your current payment terms?
- Is it taking you more or less time to get paid than your terms require?

Use your receivable days to determine if your customers are taking too long to pay you, past your payment terms – this means you need to work differently to chase your debt. For example, if your payment terms allow customers 30 days to pay, but they regularly take 60 days, you face a 30-day gap where you're expecting cash that hasn't arrived.

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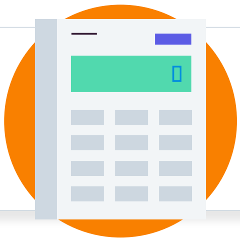
Measuring payable days

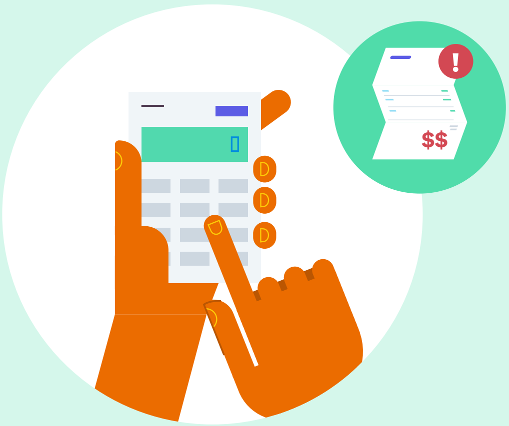
Another measure of efficiency to consider is your payable days. This is the number of days it takes your business to pay its suppliers.

Purchases ÷ Payables × 365 = **Payable days**



There can be benefits to paying suppliers earlier than their payment terms require, like securing a discounted rate or avoiding late fees. However, paying too quickly can also weaken your position if you want to negotiate for better terms.

Calculate your current payable days



Purchases (A) =

Payables (B) =

Payable days (A / B x 365) =

- Are you surprised by your payable days?
- What benefits or impacts does this have?
- What changes (if any) do you want to make to how you pay suppliers?

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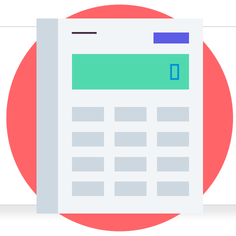
Measuring inventory turnover

You can also measure efficiency by looking at your inventory turnover if your business is product-based.

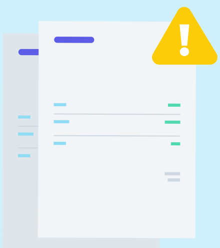
Average cost of inventory ÷ Costs of goods sold × 365 = **Inventory days**



To stock or not to stock

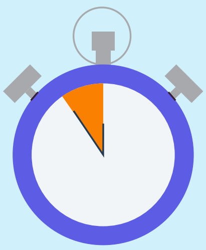
Inventory days (or turnover) tells you how long, on average, your stock remains in your business before being sold. While receivable days track how quickly money comes in, and payable days track how long you can hold onto cash before paying your suppliers, inventory days track how efficiently your business is turning over its stock.

If you keep unsold inventory for a long time, it can affect your business financially. Here's how:



Tying up money in stock means it isn't available to pay bills, invest in growth, or cover unexpected costs.

Holding stock longer increases costs for storage, insurance, and management.



Keeping stock too long can mean it goes out of date, becomes damaged, or loses value.

Discounting goods to clear out slow-moving stock reduces your profit margins.

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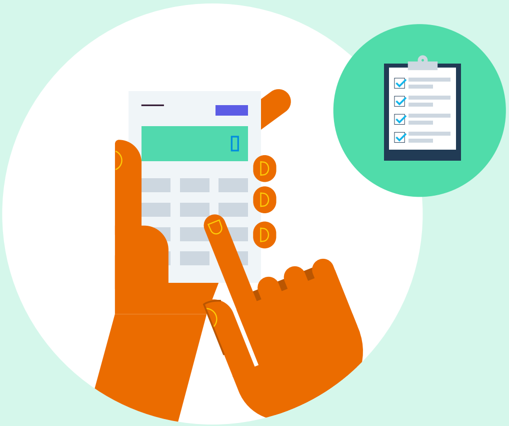
Stock isn't inherently good or bad. Having a high level of stock could be from a good deal (such as bulk purchases or sale prices) that's benefited your business.

Calculate your current inventory days



Average cost of inventory (A) =

Cost of goods sold (B) =

Inventory days (A / B x 365) =

- What are the impacts of your inventory days?

THE POWER OF EVALUATION

Let's take everything we've covered in this toolkit and see how it could impact a business. For this activity, we'll look at a simplified fictional business, Green Leaf Café.

Green Leaf Café is a small, family-run café in the city, offering dine-in and take-away options, as well as a limited catering service. The owners want to understand if the business is financially healthy and identify where improvements are needed. They've provided you with their latest financial reports.

PROFIT & LOSS STATEMENT	YEAR ENDING 30 JUNE
Sales (revenue)	$400,000
Cost of goods sold (ingredients, supplies [purchases])	$160,000
Gross profit	**$240,000**
Advertising	$40,000
Wages and other expenses	$180,000
Net profit	**$20,000**

BALANCE SHEET	AS AT 30 JUNE
Assets	
Cash	$15,000
Accounts receivable	$50,000
Inventory (food and supplies)	$25,000
Total current assets	$90,000
Liabilities	
Accounts payable	$40,000
Short-term loan	$20,000
Total current liabilities	$60,000
Owner's equity	**$30,000**

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Your tasks

Calculate the key ratios:

Profitability measures

Net profit margin

Liquidity measures

Current ratio

Efficiency measures

Receivable days

Payable days

Inventory turonver days

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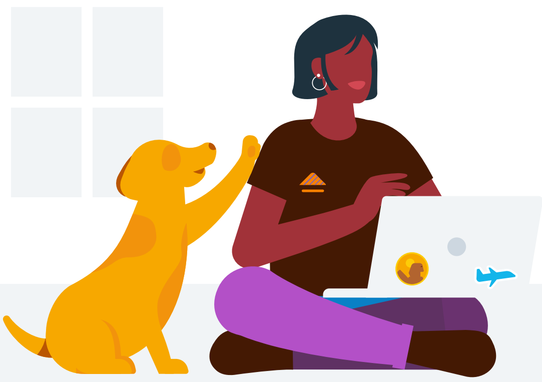
What number worries you most and why?

If you owned Green Leaf Café, what 2-3 actions would you take? Why?

What trends can you spot for this business, based on the big three ratios?

What non-financial information would you want to gather for this business? Why?



Want to compare your thoughts?
Check out what we noticed on page 21

Putting the big three together

Let's check back in on your business after completing the toolkit and looking at the fictional example.

- What metrics will you measure in future? Why?
- How frequently will you monitor them? Why?
- What decisions will they help you make?

Next, pick one of the big three metrics (profitability, liquidity or efficiency) that you'd like to improve.

- What target do you want to set? (For example, I want to improve my current ratio from 1:1 to 1.5:1)
- What are three actions you can take to meet your target?
- What will meeting your target mean for your business?

What is one habit you will commit to that will help you use your numbers to guide your decisions?

USING METRICS TO GUIDE YOUR DECISIONS

A simple way to use your metrics to guide your financial decisions is to create a dashboard, so all the information you need is in one place.

You don't need to make it complex or use specialised software (although this can make things easier as your business grows). If you use a simple spreadsheet to track your numbers over time, you can quickly see everything you need to know.

Try creating a dashboard. Use a spreadsheet or paper and capture:

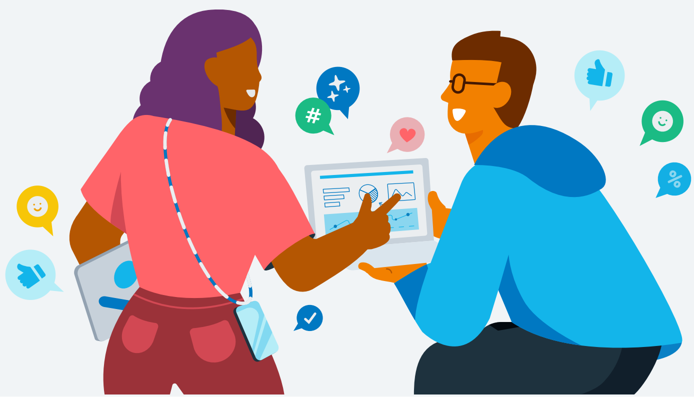
- Profitability (using your net profit margin)
- Liquidity (using the current ratio)
- Efficiency (using receivable and payable days)
- At least one non-financial metric, such as repeat customers or customer feedback

Make a note to check back in a month to review and adjust.

The long-term stability of your business isn't just about numbers – there are also operational and market conditions that can have an impact.

That's why it's important to include non-financial metrics alongside your financial ones, so you can think about the other implications.

For example, if your customer satisfaction indicators are high, how will you make sure that any changes you make to improve your finances do not negatively impact your customer experience?



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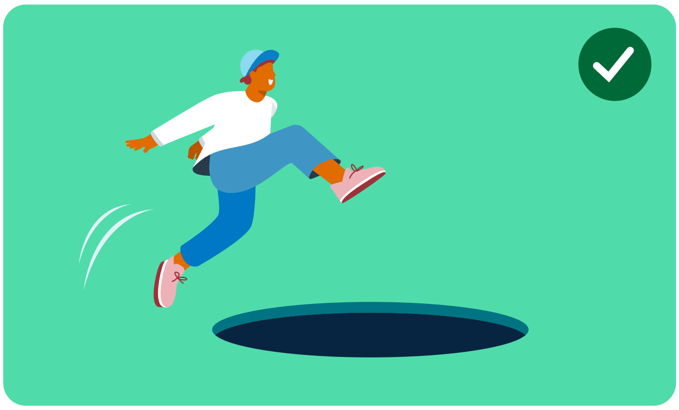
Staying stable

Here are some common pitfalls that can impact the stability of your business – and what you can do to avoid them:



Possible pitfall	How to actively avoid
Expanding the business faster than you have the cash available for	Use your dashboard and financial statements to align growth with cash flow, available cash, and other trends
Relying heavily on one client or supplier	Diversify – consider seeking out other suppliers where you can, and generate demand to find new clients
Paying your suppliers too early	Consider delaying your timing or negotiating better terms for continued early payment
Customers paying you too late	Review your credit control processes
Ignoring non-financial warning signs	Include non-financial metrics that matter in your dashboard and monitor them like you monitor your numbers

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The Green Leaf Café explained

Let's review the case study. How did you go? What did you notice compared to the below?

Profitability measures	
Net profit margin	$20,000 / $400,000 x 100 = 0.05 (5%)

Liquidity measures	
Current ratio	$90,000 / $60,000 = 1.5 (1.5:1)

Efficiency measures	
Receivable days	$50,000 / $400,000 x 365 = $45.6 (46 days)
Payable days	$40,000 / $160,000 x 365 = $91.3 (91 days)
Inventory turnover days	$25,000 / $150,000 x 365 = 57.0 (57 days)

Trends, concerns and actions

Here are some common pitfalls that can impact the stability of your business – and what you can do to avoid them:

The numbers for Green Leaf Café tell us a few things:

- Their current ratio is healthy – they have enough current assets to cover their liabilities
- Their payable days are good if suppliers allow 90 days to pay
- The receivable days mean cash is tied up for over a month
- The difference between their receivable and payable days is good, as they are collecting money faster than they are paying money
- Being a café, their inventory may be perishable. The inventory days may indicate stock sitting in the business for longer than anticipated

Some concerns the owners might have:

- Cash is tight, as they only have $15,000 available
- Receivable days could seem high for a café, which is likely connected to the catering service
- Net profit margin is slim at only 5%

The owners could take a few actions to address these concerns:

- Look at their payment terms and credit control processes, particularly for their catering customers. Can they improve their receivable days and reduce the payment delays?
- Consider taking steps to improve profitability – is it time to increase prices, or can they find ways to reduce costs?
- Gather customer feedback for both their café and catering customers, to check in on pricing and payment options and validate any changes they're considering

< Healthy habits toolkit

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APPENDIX

Free small business guides from the Australian Taxation Office

https://www.ato.gov.au/tax-and-super-professionals/for-tax-professionals/prepare-and-lodge/tax-time/tax-time-toolkits/tax-time-toolkit-small-business/small-business-guides

Frequently asked questions

https://financialfitness.xero.com/en-au/contact

Quick vs current ratio

https://www.xero.com/au/glossary/quick-vs-current-ratio/

Resources from the Australian Government, covering financial management, cash flow templates, and business owner mental health/wellbeing

https://business.gov.au/finance

Services to help if you are experiencing financial difficulties

https://moneysmart.gov.au/

What are liquidity ratios?

https://www.xero.com/au/guides/liquidity-ratios/

What is liquidity?

https://www.xero.com/au/glossary/liquidity/

What is profitability?

https://www.xero.com/au/glossary/profitability/

What is the quick ratio?

https://www.xero.com/au/glossary/quick-ratio/

Xero For Good Ambassador Program

https://financialfitness.xero.com/en-au/join-mentorloop

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