

15 Industry benchmarks

In recent years the Tax Office has worked in conjunction with community groups, industry representatives and tax practitioners on a range of activities. These activities are aimed at maintaining the integrity of the tax system, encouraging and improving record keeping practices among businesses, and reducing (as much as possible) compliance costs for business, particularly small business. Providing financial ratios or 'benchmarks' is one such activity.

Financial ratio data related to gross profit, net profit and wages to turnover provides useful indicators of business activity and performance for tax practitioners, the business community and the Tax Office. The data is widely used in external publications and can be calculated from income tax return data.

The industry benchmark detailed tables contain financial ratio benchmark data for each entity type and most business activities (see box 15.2). The ratios calculated for each business activity have been used to produce two sets of mean average ratio values. The first set includes both profit-making and loss-making entities. It provides a benchmark figure for an entire business activity/industry division or group (box 15.2). The second set of ratios excludes businesses that return a loss, providing an industry average for 'profitable' businesses only.

Box 15.1: Ratios calculated

Gross profit ratio: total business income minus cost of sales, divided by total business income.

Net profit ratio: total business income minus total expenses, divided by total business income.

Wages to turnover ratio: salary and wages paid, divided by total business income.

Source of industry benchmarks/industry financial ratios

The data for *Taxation statistics 2001–02* was compiled before all processing for the 2001–02 income year was completed. The data used to calculate the ratios for the business activities and entities is sourced from statistics collected from 2002 individual, company, partnership and trust income tax returns processed by 31 October 2003.

The names of the business activity groups used in the tables are based on the Australian and New Zealand Standard Industry Classification (ANZSIC) system. The numerical codes corresponding to these business activity names are referred to as business activity codes. For this edition of *Taxation statistics*, the industry benchmark tables show ratios for business activities at the ANZSIC division and group (three-digit) levels (see box 15.2).

Box 15.2: Business activity codes

A complete list of the activities and the corresponding codes for the 2001–02 income year are in our publication *Business industry codes 2002*. There is a copy of this publication on the attached CD-ROM and on our website at www.ato.gov.au

The publication lists industries under ANZSIC divisions and groups. For example, under the ANZSIC division 'Agriculture, forestry and fishing', the following groups of business activities are listed:

- Horticulture, forestry and fishing
- Grain, sheep and beef cattle farming
- Dairy cattle farming
- Poultry farming
- Other livestock farming
- Other crop growing
- Services to agriculture
- Hunting and trapping
- Forestry and logging
- Marine fishing, and
- Aquaculture

Under these groups, more specific business activities are listed with their corresponding Tax Office five-digit code. **The first three digits of this code is the ANZSIC group code.** For example, under poultry farming, 10 activities are listed:

- chicken farming – for meat (01410)
- duck farming (01410)
- game bird farming (01410)
- goose farming (01410)
- poultry farming – for meat (01410)
- poultry hatchery operation – meat breeds (01410)
- turkey farming (01410)
- egg farm operation (01420)
- poultry farming – for eggs (01420)
- poultry hatchery operation – egg breeds (01420)

All 10 business activities have '014' as their ANZSIC group code.

In this edition of *Taxation statistics*, the industry benchmark tables show ratios for business activities at the ANZSIC division and group (three-digit) levels. That is, a mean ratio is calculated for each ANZSIC division and for each ANZSIC group within a division. For example, a mean ratio is available for all business activities classified under 'poultry farming' (all businesses with '014' as the first three digits of their business activity code).

However, ratios may not be available for some ANZSIC groups (three-digit level) and/or entities because:

- there is insufficient data to calculate the ratios
- there are data quality problems, and/or
- the data cannot be shown for confidentiality reasons.

1. For more information on the Australian and New Zealand Standard Industry Classification (ANZSIC) system, division and group levels, see the Australian Bureau of Statistics (ABS) publication *Australian and New Zealand Standard Industrial Classification (ANZSIC)*, Cat. No. 1292.0. This publication can be viewed on the ABS website at www.abs.gov.au

The purpose of benchmarks

Benchmarks help tax advisers identify averages for groups of activities and, therefore, businesses that vary significantly from those averages. Tax advisers can use this information to determine the reasons for any variation and identify action that should be taken to correct problems and improve business practices – in particular those related to record keeping.

The business community and business owners generally may use benchmarks to compare the performance of their business with industry averages.

For example, a low gross profit ratio may indicate to a business owner that:

- their job quotes or prices are lower than those of their competitors
- they are paying too much for their stock purchases
- there is wastage of materials due to overestimating job requirements
- they do not have enough sales in higher profit margin lines (poor sales mix)
- they need to improve merchandising or product displays, or
- their stock level is too high and it may be better to buy stock as needed to improve their cash flow.

A low net profit ratio may indicate that some operating expenses are high compared to industry averages. A business owner might need to look at:

- the location of their business and rent expenses
- the level of contractor and subcontractor expenses
- the number of employees and their effectiveness
- the cost of business motor vehicles, and
- the cost of other major overheads.

A high wages to turnover ratio for a business owner might suggest that quotes for jobs are too low. This ratio could also be an indicator of the efficiency of labour used in a business. In particular, an owner may consider:

- the rate at which employees produce income
- the time taken to complete jobs, and
- the pay rates of employees.

The business community may also use these ratios when evaluating job tenders. The gross profit and net profit ratios of a business compared to the industry average may be one factor that is taken into account in deciding whether a particular tender is successful.

For the Tax Office, providing access to benchmark information is part of a commitment to being more open and up-to-date in our operations and forms part of our industry-based project approach to compliance. In providing benchmarks for businesses, we aim to have a more direct impact on taxpayer behaviour before tax returns are prepared and lodged. Feedback from tax professionals indicates that the use of benchmarks in preparing tax returns is increasing.

Once tax returns are lodged, we use benchmarks – together with a range of other information – to identify any compliance issues and any clients that may require further assistance or monitoring. The wages to turnover ratio, in particular, provides a relevant measure in those industries where cash wages are common. We may also use benchmarks to compare taxpayers and may seek further information from clients whose ratios vary substantially from their industry averages.

Box 15.3: Terminology

Cost of sales: for income tax purposes, cost of sales is defined as the cost of anything produced, manufactured, acquired or purchased for manufacture, sale or exchange in deriving the gross proceeds or earnings of the business. In some cases, other expenses such as salary and wages and rent are included in the cost of sales figure, which overstates the cost of sales amount.

Industry: income tax returns allow for only one business industry code to be shown. For entities involved in more than one business, it is not possible to separately identify the amount of income and expenses attributed to the major business activity.

Salary and wage expenses: this return label is not used in calculating taxable income. It is a non-compulsory information label and is therefore more likely to contain errors.

Ratios

The data shows that the net profit ratios of companies and trusts are generally lower than those of partnerships and individuals. This is because the salary and wages income returned is generally a business expense for the owners of a company or working beneficiaries of a trust. However, in a partnership the income returned to the partners comes in the form of a distribution of net income after business expenses are deducted. A similar situation occurs for individuals.

For the same reason, the wages to turnover ratios for individuals and partnerships are lower than those of companies and trusts.

Exclusions and considerations

When analysing a large population, the inclusion of some cases can produce misleading results. For example, income tax return labels used in the calculations may not have been completed or not completed correctly, or the ratios for an individual entity are exceptional and would distort the calculation of a true industry average.

In an attempt to improve the quality of the end product, certain exclusion criteria have been developed and applied. (There is a list and explanation of these exclusion criteria in all the industry benchmark tables.)

Despite the application of these exclusion criteria, it is still important to recognise that the benchmarks developed are not definitive and should not be used in isolation. For example, there is a range of legitimate reasons as to why businesses vary from industry averages and, conversely, businesses with ratios close to the industry average may have compliance problems or other financial difficulties. Also, an average ratio calculated using a large population is generally more reliable than one calculated from a small population.

Benchmarks are most useful as a guide when considered over a period of time or in conjunction with other information. For example, the age of the business and its performance over a number of years should also be taken into account when considering the viability of a business.

Future developments

Tax reforms introduced a range of measures aimed at improving compliance. Activity statements, for example, provide a source of up-to-date trading information.

Activity statement data helps us identify and address issues likely to have a negative impact on revenue as they emerge, rather than after they become ingrained business practice.

A current Tax Office project is using activity statement data to assess the performance of businesses against eight separate financial ratios in order to establish industry level benchmarks or norms. Businesses whose performance against those ratios suggests they may be operating outside their industry norms are identified for closer analysis and, if necessary, for follow-up.

We propose to provide activity statement benchmark data as part of the industry benchmarks in a future edition of *Taxation statistics*.

Detailed tables

Box 15.4: Using and finding industries/business activities in the detailed tables

Before viewing/downloading the industry benchmark tables from the CD-ROM or from the online version of this publication on our website at www.ato.gov.au, we recommend that users first read the other parts of this chapter (particularly box 15.2) and the exclusion criteria explanatory notes included in all the industry benchmark tables. These explain what the ratios are, what items were used to calculate them, how the ratios were calculated and how to properly interpret the ratios.

In most cases, people who use the industry benchmark tables are after ratios for a specific industry/business activity. To find ratios for a particular industry, we recommend users to download our publication *Business industry codes 2002* before downloading the tables. By going through this document, users will have a better idea as to which industry a business, service or activity will be classified under, and the industry code assigned to the business, service or activity.

After downloading this booklet, users may download the detailed tables in their preferred format (XLS, PDF or CSV) and then follow the instructions included with the tables.

There are three main types of industry benchmark detailed tables. They all contain gross profit ratios, net profit ratios and wages to turnover ratios for business activity/industry (ANZSIC) divisions and groups listed in our publication *Business industry codes 2002*.

The tables are:

Table 1	Industry benchmarks, by business status, 2001–02 income year
(Parts A to I)	<p>This table calculates gross profit, net profit and wages to turnover ratios for profitable and all entities falling under different business activity/industry (ANZSIC) divisions or groups. Each ANZSIC division or group is classified by business status – ‘commenced business’ (businesses that just started) and ‘established business’. Industry ratios are therefore calculated for ‘commenced’ and ‘established’ business entities.</p> <p>Note: Ratios may not be available for some business (ANZSIC) group codes and/or entities because there is insufficient data to calculate the ratios, there are data quality problems or the data cannot be shown for confidentiality reasons.</p>
Table 2	Industry benchmarks, by state/territory, 2001–02 income year
(Parts A to I)	<p>This table calculates gross profit, net profit and wages to turnover ratios for profitable and all entities falling under different business activity/industry (ANZSIC) divisions or groups. Each ANZSIC division or group is classified by state/territory. Industry ratios are therefore calculated for business entities in different states/territories.</p> <p>Note: Ratios may not be available for some business (ANZSIC) group codes and/or entities in certain states/territories because there is insufficient data to calculate the ratios, there are data quality problems or the data cannot be shown for confidentiality reasons.</p>

Table 3	Industry benchmarks, by total business income/total income, 2001–02 income year
(Parts A to I)	<p>This table calculates gross profit, net profit and wages to turnover ratios for profitable and all entities falling under different business activity/industry (ANZSIC) divisions or groups. Each ANZSIC division or group is ranged by total business income for individual, partnership and trust benchmark tables and ranged by total income for company benchmark tables. Industry ratios are therefore calculated for business entities falling under different ranges of total business income or total income, depending on the entity.</p> <p>Note: Ratios may not be available for some business (ANZSIC) group codes and/or entities because there is insufficient data to calculate the ratios, there are data quality problems, or the data cannot be shown for confidentiality reasons.</p>

Tables 1 to 3 contain the benchmark data. Each of these tables is divided into a number of smaller sections to help locate specific information. **Part A** contains benchmark ratios calculated for broad industries (or ANZSIC division). The ratios for fine industries (or ANZSIC groups) are presented in **Parts B to H**, according to broad industry headings, as follows:

Part B:	Agriculture, forestry and fishing
	This part contains ratios for business activities with codes beginning with the digits: 011, 012, 013, 014, 015, 016, 021, 022, 030, 041 and 042.
Part C:	Manufacturing
	This part contains ratios for business activities with codes beginning with the digits: 211, 212, 213, 214, 215, 216, 217, 218, 219, 221, 222, 223, 224, 225, 226, 231, 232, 233, 241, 242, 243, 251, 252, 253, 254, 255, 256, 261, 262, 263, 264, 271, 272, 273, 274, 275, 276, 281, 282, 283, 284, 285, 286, 291, 292 and 294.
Part D:	Wholesale trade
	This part contains ratios for business activities with codes beginning with the digits: 451, 452, 453, 461, 462, 471, 472, 473 and 479.
Part E:	Mining; electricity, gas and water supply
	This part contains ratios for business activities with codes beginning with the digits: 110, 120, 131, 141, 142, 151, 361, 362 and 370.
Part F:	Construction; transport and storage; communication
	This part contains ratios for business activities with codes beginning with the digits: 411, 412, 421, 422, 423, 424, 425, 611, 612, 620, 630, 640, 650, 661, 662, 663, 664, 670, 711 and 712.

Part G:	Finance and insurance; property and business services
	This part contains ratios for business activities with codes beginning with the digits: 731, 732, 733, 734, 741, 742, 751, 752, 771, 772, 773, 774, 781, 782, 783, 784, 785 and 786.
Part H:	Education; cultural and recreational services; personal and other services; health and community services
	This part contains ratios for business activities with codes beginning with the digits: 841, 842, 843, 844, 911, 912, 921, 922, 923, 924, 925, 931, 932, 933, 951, 952, 961, 962, 963, 861, 862, 863, 864, 871 and 872.
Part I:	Retail trade; accommodation, cafes and restaurants
	This part contains ratios for business activities with codes beginning with the digits: 511, 512, 521, 522, 523, 524, 525, 526, 531, 532, 571, 572, 573 and 574.

Tables 1 to 3 also contain instructions on how to find industries and ratios in the tables and information on how the ratios were calculated, particularly the exclusion criteria used to calculate the ratios.

Each entity – individuals (or personal taxpayers), companies, partnerships and trusts – has its own respective tables 1 to 3, with each table having 9 parts (A to I).

A complete list of industry benchmark tables for all the entities is listed below. Overall, there are 108 industry benchmark tables (counting each part as a table).

Individuals

Table IN1:	Individual industry benchmarks, by business status, 2001–02 income year (parts A to I)
Table IN2:	Individual industry benchmarks, by state/territory, 2001–02 income year (parts A to I)
Table IN3:	Individual industry benchmarks, by total business income, 2001–02 income year (parts A to I)

Companies

Table CO1:	Company industry benchmarks, by business status, 2001–02 income year (parts A to I)
Table CO2:	Company industry benchmarks, by state/territory, 2001–02 income year (parts A to I)
Table CO3:	Company industry benchmarks, by total income, 2001–02 income year (parts A to I)

Partnerships

Table PA1:	Partnership industry benchmarks, by business status, 2001–02 income year (parts A to I)
Table PA2:	Partnership industry benchmarks, by state/territory, 2001–02 income year (parts A to I)
Table PA3:	Partnership industry benchmarks, by total business income, 2001–02 income year (parts A to I)

Trusts

Table TR1:	Trust industry benchmarks, by business status, 2001–02 income year (parts A to I)
Table TR2:	Trust industry benchmarks, by state/territory, 2001–02 income year (parts A to I)
Table TR3:	Trust industry benchmarks, by total business income, 2001–02 income year (parts A to I)