RETURN ON CAPITAL (RETURN ON ASSETS RoA)

The rate of return on capital is; adjusted net farm income, less the opportunity cost of labour and management, and is expressed as a percentage of the total capital used in the business. The goal for the rate of return on capital should be, at least, the interest rate on borrowed capital.

Return on capital is calculated as follows;

OP (plus other net income + add back runoff adj)

Total capital (Assets owned) = RoC

(Note: The runoff adjustment is excluded from the adjustments when calculating EFS when the total asset includes the value of the runoff)

If all the capital in the business is owner’s equity with no borrowing, the capital will have an opportunity cost equal to the return in its best alternative use outside the business. Hence the goal for ROC should be at least the interest paid on the borrowed capital.

RETURN ON EQUITY (RoE)

Indicates the percentage return to the owner’s personal equity or capital. If borrowed money is used in the business, the ROE should be higher than the ROC.

ROE = EFS (plus other income) – Interest less lease payments

Equity