DebtEquity Ratio

1. Explain

Shows the financial structure of the co.
Relationship between debt and equity for the company
Shows how much the business has borrowed relative to the amount invested by owners

Debt Capital= long-term debt + preference shares (if any)

Equity Capital = ordinary share Capital + reserves (retained earnings)

High Gearing: debt > equity

Business has borrowed more money than is invested by shdrs

High Interest

High interest payments on borrowing must be met before company can pay dividends

Difficult to sell shares

May be difficult to sell shares in the future because of poor previous dividends

Selling Shares

If shdrs become frustrated with poor dividend payment they may sell shares, resulting in a fall in share price

Bankruptcy

A business with lots of loans is more likely to become bankrupt because of high interest repayments

Low gearing: debt< equity

Borrowed less than is invested by shdrs

Easy to sell shares

Should be easy to sell shares because of good dividends to shareholders

Easier to borrow

In future business should be able to borrow because of low levels of borrowing currently

Owners capital

A greater amount of the capital is provided by the owners

Interest

No major interest falling due each year so a large proportion of profits is available to pay dividends or to reinvest in the company

Neutrally geared: debt = equity

Business has borrowed same amount as invested by shdrs