# DEBT EQUITY RATIO

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**In this lesson we will understand "Debt", "Equity" & "Debt Equity ratio"**

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# DEBT EQUITY RATIO

**In life we should be grateful to all those who have helped us in making us what we are.**

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# DEBT EQUITY RATIO

**So who are these people we need to be indebted to?**

**They are our teachers, mentors, leaders etc who light up the path that we tread upon**

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We owe them our success.

And in return they earn “Guru Dakshina” in the form of their fees.

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# DEBT EQUITY RATIO

**So while we gather knowledge from our teachers and progress in life by earning wealth and fame, all that they receive is their professional fees and goodwill from some students.**

**Even if we are unable to make the most of our education and fail to make it big in life the amount of professional fees remains the same. Hence the "Guru Dakshina" remains fixed irrespective of the outcome.**

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# DEBT EQUITY RATIO

This "guru dakhina" is similar to the debt companies take from banks. Whether the companies deploy the money profitably or not they are liable to repay their debts.

And of course companies should be grateful or indebted to the banks who help them to succeed by providing capital at the right time.

# DEBT EQUITY RATIO

**While we remember our teachers, we must not forget the teachers who never demanded their "guru dakshina" from us.**

**Who are they?**

# DEBT EQUITY RATIO

**They are our parents. They laid the foundation of our lives. They taught us our values and beliefs. And if we stand tall today it is because of the platform they gave us earlier in life.**

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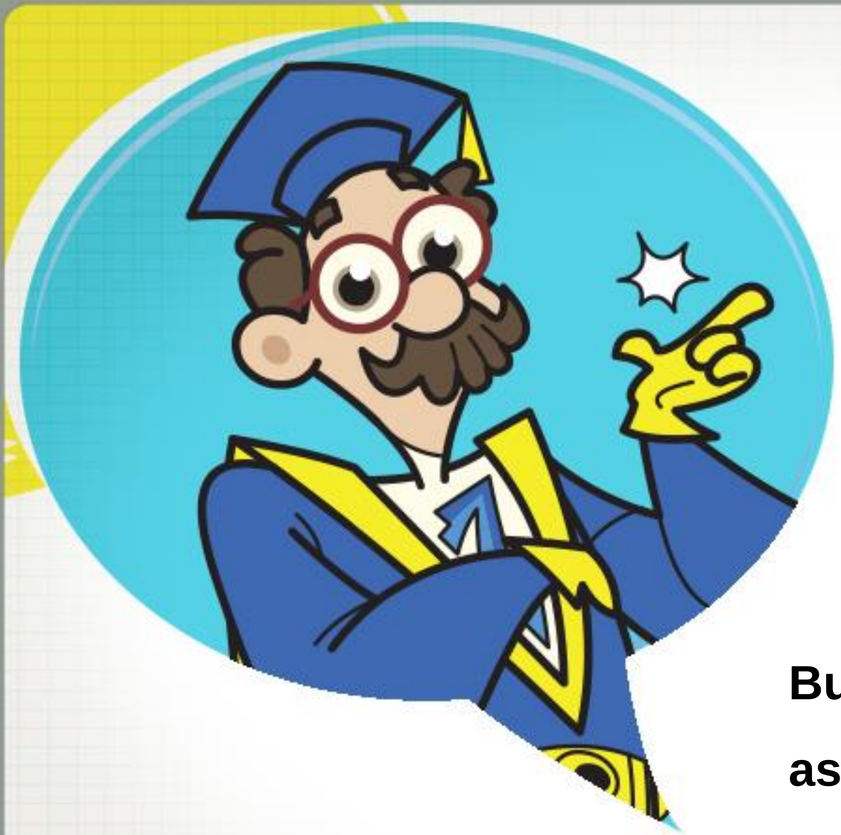

**But they never took a fee or asked for their share of “Guru Dakshina”.**

**Why did they do that?**

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# DEBT EQUITY RATIO

They did that because for them their “returns” were directly linked with our well-being . Their happiness, their success and their “guru dakshina” was to see us succeed.

Since they never asked for professional fees, their contribution cannot be termed as debt.

So what is it?

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**Their participation in our lives can be compared with "equity" participation of investors in companies**

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**Investors who participate by way of equities take the risks and do not demand a fee. They allow the company to perform without worrying too much about timely returns. In that sense they allow more “elbow room” to the management. Whether the company succeeds or fails they are part of its destiny.**

**However, they earn their returns if the company turns profitable.**

**Similarly parents think of their children’s success as their returns.**

# DEBT EQUITY RATIO

**Thus while “debt” is like paying professional fees to teachers, “equity” is like the sharing of one’s fame and success with parents.**

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# DEBT EQUITY RATIO

**Hope the concept of “Debt” and “Equity” has been made clear for you. Now let us look at the Debt : Equity ratio.**

**So as per our understanding we can now see this ratio from a different perspective.**

**While debt has to be serviced on time, “returns” for equity investors can be paid out of net surplus.**

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So if Debt : Equity ratio is 2:1 it means the company has larger debt on its books. Companies which are capital intensive have high ratios. Another interpretation of a high ratio could be that the management's confidence in the business is high.

But investors should realize that a very high Debt : Equity ratio also means higher debt obligations and hence accompanied risks

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# DEBT EQUITY RATIO

**If the Debt: Equity ratio is 1:1 it means that the company does not have much debt obligations on its books. Software companies which have limited capital investments usually have a lower Debt : Equity ratio.**

**Sometimes a low Debt : Equity ratio could also mean that the company is not aggressive enough**

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# DEBT EQUITY RATIO

However what is most important is the fact that Debt :

Equity ratio might be a necessary measure to judge the health of a company but is not a sufficient measure to come to any conclusion. One would have to study other parameters like Gross and Net Profit, ROCE, ROE, etc before coming to any sort of conclusion about the health of the company.

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# DEBT EQUITY RATIO

**Hope this lesson has succeeded in clarifying the concept of “Debt"," Equity” & “Debt : Equity ratio”**

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**Thinking of Investment**

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