29

ACCOUNTING RATIOS – II

You have learnt in the previous lesson that accounting ratios can be classified into five major groups viz. liquidity ratios, activity ratios, solvency ratios, profitability ratios and leverage ratio. You have already learnt the meaning, computations and significance of liquidity and activity ratios. In this lesson, you will learn about the various solvency ratios, profitability ratios and leverage ratio and their significance.

OBJECTIVES

After studying this lesson you will be able to :

- explain various types of accounting ratios i.e. solvency, profitability and leverage ratios;
- calculate the various ratios on the basis of given information;
- describe the limitations of accounting ratios.

29.1 SOLVENCY RATIOS

The term 'solvency' refers to the ability of a concern to meet its long term obligations. The long-term liability of a firm is towards debenture holders, financial institutions providing medium and long term loans and other creditors selling goods on credit. These ratios indicate firm's ability to meet the fixed interest and its costs and repayment schedules associated with its long term borrowings.

The following ratios serve the purpose of determining the solvency of the business firm.

- Debt equity ratio
- Proprietary ratio

Notes

Debt-equity ratio

It is also otherwise known as external to internal equity ratio. It is calculated to know the relative claims of outsiders and the owners against the firm's assets. This ratio establishes the relationship between the outsiders funds and the shareholders fund. Thus,

$$\boxed{\text{Debt-equity ratio} = \frac{\text{Outsiders' funds}}{\text{Share holders' funds}}}$$

The two basic components of the ratio are outsiders' funds and shareholders' funds. The outsiders' funds include all debts/liabilities to outsiders i.e. debentures, long term loans from financial institutions, etc. Shareholders' funds mean preference share capital, equity share capital, reserves and surplus and fictitious assets like preliminary expenses. This ratio indicates the proportion between shareholders' funds and the long-term borrowed funds. In India, this ratio may be taken as acceptable if it is 2 : 1. If the debt-equity ratio is more than that, it shows a rather risky financial position from the long term point of view.

Significance

The purpose of debt equity ratio is to derive an idea of the amount of capital supplied to the concern by the proprietors. This ratio is very useful to assess the soundness of long term financial position of the firm. It also indicates the extent to which the firm depends upon outsiders for its existence. A low debt equity ratio implies the use of more equity than debt.

Illustration 1

From the following, calculate the debt-equity ratio

	Rs.
Equity Shares Capital	1,00,000
General Reserve	45,000
Accumulated Profits	30,000
Debentures	75,000
Sundry trade creditors	40,000
Outstanding expenses	10,000

Solution :

$$\text{Debt-equity ratio} = \frac{\text{Debt (Total long - term loans)}}{\text{Equity (Shareholders Funds)}}$$

$$= \frac{\text{Rs } 75{,}000}{\text{Rs } 1{,}75{,}000} = 3 : 7$$

Working Notes : Shareholders' fund = Equity share capital + Reserves + Accumulated profits

(i) Rs100000 + Rs45000 + Rs30000 = Rs175000

(ii) Long term debt = Debentures = Rs75000

Illustration 2

Calculate the debt-equity ratio from the following data :

Total Assets Rs1,20,000. Total debt Rs1,00,000 current liabilities Rs 60,000.

Solution :

Calculation of debt-equity ratio

Long term debt = Total debt – current liabilities

= Rs 1,00,000 – Rs 60,000

= Rs 40,000

Shareholders' fund = Total Assets – total debt

= 1,20,000 – Rs 1,00,000

= Rs 20,000

$$\text{Debt equity ratio} = \frac{\text{Debt}}{\text{Equity}}$$

$$= \frac{\text{Rs } 40{,}000}{\text{Rs } 20{,}000} = 2$$

Proprietory ratio

It is also known as equity ratio. This ratio establishes the relationship between shareholders' funds to total assets of the firm. The shareholders' fund is the sum of equity share capital, preference share capital, reserves and surpluses. Out of this amount, accumulated losses should be deducted. On the other hand, the total assets mean total resources of the concern. The ratio can be calculated as under :

$$\boxed{\text{Proprietory ratio} = \frac{\text{Shareholders' funds}}{\text{Total assets}}}$$

Notes

Significance

Proprietary ratio throws light on the general financial position of the enterprise. This ratio is of particular importance to the creditors who can ascertain the proportion of shareholders' funds in the total assets employed in the firm. A high ratio shows that there is safety for creditors of all types. Higher the ratio, the better it is for concerned.

A ratio below 50% may be alarming for the creditors since they may have to lose heavily in the event of company's liquidation on account of heavy losses.

Illustration 3

From the following calculate the proprietary ratio :

	Rs
Equity share capital	1,00,000
Preference share capital	50,000
Reserves and surpluses	25,000
Debentures	60,000
Creditors	15,000
Total	2,50,000
Fixed assets	1,25,000
Current Assets	50,000
Investment	75,000
Total	2,50,000

Solution :

$$\text{Proprietary ratio} = \frac{\text{Shareholders' funds}}{\text{Total assets}}$$

$$= \frac{\text{Rs } 1,75,000}{\text{Rs } 2,50,000} = 0.7 \text{ or } 70\%$$

INTEXT QUESTION 29.1

Fill in the blanks with suitable word/words/figures :

(i) Debt equity ratio = ...

(i) .... ratio measures the long term obligation of a firm.

(iii) .... $= \dfrac{\text{Shareholders' fund}}{\text{Total Assets}}$

(iv) Debt equity ratio =

29.2 PROFITABILITY RATIOS

The main aim of an enterprise is to earn profit which is necessary for the survival and growth of the business enterprise. It is earned with the help of amount invested in business. It is necessary to know how much profit has been earned with the help of the amount invested in the business. This is possible through profitability ratio. These ratios examine the current operating performance and efficiency of the business concern. These ratios are helpful for the management to take remedial measures if there is a declining trend. The important profitability ratios are :

(i) Gross profit ratio

(ii) Net profit ratio

(iii) Operating profit ratio $\dfrac{2,00,000}{3,00,000}$

(iv) Return on investment ratio

(i) Gross profit ratio

It expresses the relationship of gross profit to net sales. It is expressed in percentage. It is computed as

$$\boxed{\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100}$$

where Net sales = Total sales – (sales returns + excise duty)

Gross profit = Net sales – Cost of goods sold.

Significance

Gross profit ratio shows the margin of profit. A high gross profit ratio is a great satisfaction to the management. It represents the low cost of goods sold. Higher the rate of gross profit, lower the cost of goods sold.

Illustration 4

From the following detail of a business concern ascertain the gross profit ratio :

Details	2005 (Rs)	2006 (Rs)
Sales	120,000	160,000
Gross profit	40,000	60,000

Solution :

2005 Gross profit ratio $= \dfrac{\text{Rs } 40{,}000}{\text{Rs } 120{,}000} \times 100 = 26.67\%$

2006 Gross profit ratio $= \dfrac{\text{Rs } 60{,}000}{\text{Rs } 160{,}000} \times 100 = 37\dfrac{1}{2}\%$

Illustration 5

Calculate the gross profit ratio from the following data :

Sales Rs.3,25,000 sales returns Rs.25,000 and cost of goods sold 2,40,000

Solution.

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$$

Gross Profit = Net sales – cost of goods sold

= 300,000 – 2,40,000 = 60,000

$$\text{Gross Profit Ratio} = \frac{60{,}000}{3{,}00{,}000} \times 100 = 20\%$$

(ii) Net profit ratio

A ratio of net profit to sales is called Net profit ratio. It indicates sales margin on sales. This is expressed as a percentage. The main objective of calculating this ratio is to determine the overall profitability. The ratio is calculated as :

$$\boxed{\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100}$$

Significance

Net profit ratio determines overall efficiency of the business. It indicates the extent to which management has been effective in reducing the operational expenses. Higher the net profit ratio, better it is for the business.

Illustration 6

Calculate Net profit ratio from the following :

Net profit	Rs 45,000
Sales	Rs 640,000
Sales Returns	Rs 40,000

Solution :

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

$$\text{Net sales} = \text{Sales} - \text{Sales returns}$$

$$= \text{Rs } 640{,}000 - \text{Rs } 40{,}000 = \text{Rs } 600{,}000$$

$$\text{Net profit ratio} = \frac{\text{Rs } 45{,}000}{\text{Rs } 600{,}000} \times 100 = 7.5\%$$

Illustration 7

Calculate gross profit ratio and net profit ratio from the following figures.

Sales	Rs 150,000
Cost of goods sold	Rs 120,000
Operating expenses	Rs 12,000

Solution :

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

$$\text{Gross profit} = \text{Sales} - \text{Cost of goods sold}$$

$$= \text{Rs } 150{,}000 - \text{Rs } 120{,}000$$

$$= \text{Rs } 30{,}000$$

$$\text{Gross profit ratio} = \frac{\text{Rs } 30{,}000}{\text{Rs } 150{,}000} \times 100 = 20\%$$

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

$$\begin{aligned} \text{Net profit} &= \text{Gross profit} - \text{operating expenses} \\ &= \text{Rs } 30{,}000 - \text{Rs } 12{,}000 \\ &= \text{Rs } 18{,}000 \end{aligned}$$

$$\text{Net profit ratio} = \frac{\text{Rs } 18{,}000}{\text{Rs } 150{,}000} \times 100 = 12\%$$

(iii) Operating profit ratio

Operating profit is an indicator of operational efficiencies. It reveals only overall efficiency. It establishes relationship between operating profit and net sales. This ratio is expressed as a percentage. It is calculated as :

$$\boxed{\text{Operating profit} = \frac{\text{Operating profit}}{\text{Net sales}} \times 100}$$

Operationg Profit = Gross Profit – (Administration expenses + selling expenses)

Significance

It helps in examining the overall efficiency of the business. It measures profitability and soundness of the business. Higher the ratio, the better is the profitability of the business. This ratio is also helpful in controlling cash.

Illustration 8

From the following details of a business concern ascertain the operating profit ratio

Details	2005 Rs	2006 Rs
Sales	60,000	80,000
Interest on debentures	1,000	2,000
Net profit	3,800	6,000

Solution :

2005

$$\text{Net profit before interest} = \text{Net profit} + \text{Interest}$$
$$= \text{Rs } 3{,}800 + \text{Rs } 1{,}000$$
$$= \text{Rs } 4{,}800$$

$$\text{Operating profit ratio} = \frac{\text{Rs } 4{,}800}{\text{Rs } 60{,}000} \times 100 = 8\%$$

2006

$$\text{Net profit before interest} = \text{Rs } 6{,}000 + \text{Rs } 2{,}000$$
$$= \text{Rs } 8000$$

$$\text{Operating profit ratio} = \frac{\text{Rs } 8{,}000}{\text{Rs } 80{,}000} \times 100$$
$$= 10\%$$

> Some firms take profit before tax but usually companies take profit after tax.

Illustration 9

Calculate operating profit ratio from the following data :

	Rs
Sales	3,00,000
Gross profit	1,20,000
Administration expenses	35,000
Selling and distribution expenses	25,000
Income on investment	15,000
Loss by fire	9,000

Solution :

$$\text{Operating profit Ratio} = \frac{\text{Net operating profit}}{\text{Net sales}} \times 100$$

Notes

$$= \frac{\text{Rs}60{,}000}{\text{Rs } 3{,}00{,}000} \times 100 = 20\%$$

Note : Operating profit = Gross profit – (Administration expenses + Selling expenses)

$$= 1{,}20{,}000 - (35{,}000 + 25{,}000)$$

$$= 1{,}20{,}000 - 60{,}000$$

$$= 60{,}000$$

(iv) Return on investment ratio (ROI)

ROI is the basic profitability ratio. This ratio establishes relationship between net profit (before interest, tax and dividend) and capital employed. It is expressed as a percentage on investment. The term investment here refers to long-term funds invested in business. This investment is called capital employed.

where Capital employed = Equity share capital + preference share capital + Reserve and surplus + long term liabilities – fictitious assets – Non trading investment

or Capital employed = (Fixed asset – depreciation) + (Current Asset – Current liabilities)

or Capital employed = (Fixed Assets – Depreciation) + (Working capital)

This ratio is also known as Return on capital employed ratio. It is calculated as under

$$\boxed{\text{ROI} = \frac{\text{Net profit before interest, tax and dividend}}{\text{Capital employed}} \times 100}$$

Note : If net profit after interest, tax and dividend is given, the amount of interest, tax and dividend should be added back to calculate the net profit before interest, tax and dividend.

Significance

ROI ratio judges the overall performance of the concern. It measures how efficiently the sources of the business are being used. In other words, it tells what is the earning capacity of the net assets of the business. Higher the ratio the more efficient is the management and utilisation of capital employed.

Illustration 10

Following is the Balance sheet of X Ltd. as on 31st December 2006.

Liabilities	Amount Rs	Assets	Amount Rs
Share capital	20,00,000	Fixed Assets net	29,00,000
Reserves	6,00,000	Current Assets	25,00,000
10% loan	10,00,000	Underwriting commission	100,000
Current liabilities	14,00,000		
Profit for the year	5,00,000		
	55,00,000		55,00,0000

Find out the return on investment for the year 2006.

Solution :

			Rs
Profit before interest	:	Profit as given	500,000
Add	:	Interest	100,000
		NPBI tax & Dividend	600,000
Capital employed	:	Net Fixed Assets	29,00,0000
		Working capital	11,00,000

Current Assets – Current liabilities (i.e. 25,00,000 – 14,00,000)

$$\text{ROI} = \frac{\text{Net Profit before Interest and Dividend}}{\text{Capital employed}} \times 100$$

$$= \frac{60,00,000}{40,00,000} \times 100 = 15\%$$

Alternatively

		Share capital	20,00,000
		Reserves	11,00,000
		Loans	10,000000
Less	:	Under writing commission	1,00,000
		Capital employed	40,00,000

$$\text{ROI} = \frac{\text{Net Profit before interest and dividend}}{\text{Capital employed}} \times 100$$

$$= \frac{6,00,000}{40,00,000} \times 100 \ = \ 15\%$$

Illustration 11

From the following data, calculate the return on capital employed : Net fixed assets Rs 100,000 current assets Rs 50,000, current liabilities Rs 25,000, Gross profit Rs 32,500, Interest on long-term debt Rs 7500 tax Rs 8750, office and administrative expenses Rs 2500, selling and distribution expenses Rs 5000. There were no long term investments.

Solution :

Calculation of return on capital employed :

Net profit before interest and tax = Gross profit – office and Administrative expenses – selling and distribution expenses

= Rs 32,500 – Rs 2500 – Rs 5000

= Rs 25000

Capital employed = Net fixed Assets + Current Assets – Current liabilities

= Rs 100,000 + 50,000 – 25,000

= 1,25,000

$$\text{Return on capital employed} = \frac{\text{Net profit before interest and tax}}{\text{Capital empolyed}} \times 100$$

$$= \frac{\text{Rs } 25{,}000}{\text{Rs } 125{,}000} \times 100 = 20\%$$

Illustration 12

Given below is the Balance Sheet of M/s ABC Ltd, calculate return on investment (ROI).

Liabilities	Amont Rs	Assets	Amount Rs
Equity share capital	10,00,000	Net fixed assets	15,00,000
Reserves	2,50,000	Current Assets	12,50,000
Profit for the year	2,50,000	Discount on issue of Debentures	50,000
10% debentures	5,00,000		
Current liabilities	8,00,000		
	28,00,000		28,00,000

Solution :

$$\text{Return on investment} = \frac{\text{Net Profit before Interest, Tax and Dividend}}{\text{Capital Employed}} \times 100$$

Net profit before interest, tax and dividend

= Profit + Interest on debentures

= Rs 2,50,000 + Rs 50,000

= Rs 3,00,000

Capital employed = Equity share capital + Reserves and surplus + Debentures – Discount on debentures

= Rs 10,00,000 + Rs 2,50,000 + Rs 2,50,000 + 5,00,000 – 50,000

= 19,50,000

or Capital employed = Net fixed Assets + (current assets – current liabilities)

= Rs15,00,000 + (Rs12,50,000 – Rs8,00,000)

= Rs15,00,000 + Rs4,50,000

= Rs19,50,000

$$\text{Return on investment} = \frac{\text{Rs } 300{,}000}{\text{Rs } 19{,}50{,}000} \times 100 = 15.4\%$$

Illustration 13

From the following information, calculate return on investments

Information	Amount (Rs)
Share capital	1,60,000
General reserve	60,000
Profit and Loss A/c	1,00,000
Loan @ 15% Interest	2,00,000
Sales for the year	5,60,000
Tax paid during the year	40,000
Profit for the current year after interest and tax	80,000

Solution :

$$\text{Return on investment} = \frac{\text{Profit before interest and tax}}{\text{Capital employed}} \times 100$$

(80,000 + 40,000 + 30,000)

$$= \frac{\text{Rs } 1,50,000}{\text{Rs } 5,20,000} \times 100$$

(160,000 + 60,000 + 2,00,000)

$$= 28.84\%$$

INTEXT QUESTIONS 29.2

Fill in the blank with suitable word/words :

(i) Return on investment is a .... ratio.

(ii) Gross profit ratio = ... × 100

(iii) Capital employed = ...

(iv) .... $= \dfrac{\text{Operating Profit}}{\text{Net Sales}} \times 100$

(v) Name the ratios that relate to the profitability of a business concern ....

29.3 LEVERAGE RATIO

Leverage ratio is otherwise known as capital structure ratio. The term capital structure refers to the relationship between various long term forms of financing such as debentures (long term), preference share capital and equity share capital including reserves and surpluses. Financing the firm's assets is a very crucial problem in every business and as a rule there should be a proper mix of debt and equity capital in financing the firm's assets. Leverage or capital structure ratios are calculated to test the long term financial position of a firm. Generally capital gearing ratio is mainly calculated to analyse the leverage or capital structure of the firm

Capital gearing ratio

The capital gearing ratio is described as the relationship between equity share capital including reserves and surpluses to preference share capital and other fixed interest bearing loans. If preference share capital and other fixed interest bearing loans exceed the equity share capital including reserves, the firm is said to be highly geared. The firm is said to be low geared if preference share capital and other fixed interest bearing loans are less than equity capital and reserves.

Capital gearing ratio

$$= \frac{\text{Equity share capital} + \text{reserves and surpluses}}{\text{Preference share capital} + \text{long term debt bearing fixed interest}}$$

Significance

Capital gearing ratio is very important ratio. Gearing should be kept in such a way that the company is able to maintain a steady rate of dividend. High gearing ratio is not good for a new company or a company of which future earnings are uncertain.

Illustration 14

From the following information find out capital gearing ratio.

Source	2005 Amount (Rs)	2006 Amount (Rs)
Equity share capital	500,000	400,000
Reserves & surplus	300,000	200,000
8% preference share capital	250,000	300,000
6% Debentures	250,000	400,000

Solution :

Capital gearing ratio

$$= \frac{\text{Equity share capital} + \text{Reserves and surplus}}{\text{Preference share capital} + \text{Long term debt bearing fixed intere}}$$

For the year 2005 $= \dfrac{500,000 + 300,000}{250,000 + 250,000} = 8:5$ (Low geared)

For the year 2006 $= \dfrac{400,000 + 200,000}{300,000 + 400,000} = 8:7$ (High geared)

INTEXT QUESTION 29.3

Fill in the blanks with suitable word/words :

(i) Leverage ratio is also known as .... ratio.

(ii) .... ratio is calculated to test the long term financial position of a firm.

(iii) .... $= \dfrac{\text{Equity share capital} + \text{Reserve and Surpluses}}{\text{Preference share capital} + \text{Long term debt bearing fixed interest}}$

(iv) To study capital structure of the firm .... ratio is used.

29.4 LIMITATION OF ACCOUNTING RATIOS

Accounting ratios are very significant in analysing the financial statements. Through accounting ratios, it will be easy to know the true financial position and financial soundness of a business concern. However, despite the advantages of ratio analysis, it suffers from a number of disadvantages. The following are the main limitations of accounting ratios.

- **Ignorance of qualitative aspect**

  The ratio analysis is based on quantitative aspect. It totally ignores qualitative aspect which is sometimes more important than quantitative aspect.

- **Ignorance of price level changes**

  Price level changes make the comparison of figures difficult over a period of time. Before any comparison is made, proper adjustments for price level changes must be made.

- **No single concept**

  In order to calculate any ratio, different firms may take different concepts for different purposes. Some firms take profit before charging interest and tax or profit before tax but after interest tax. This may lead to different results.

- **Misleading results if based on incorrect accounting data**

  Ratios are based on accounting data. They can be useful only when they are based on reliable data. If the data are not reliable, the ratio will be unreliable.

- **No single standard ratio for comparison**

  There is no single standard ratio which is universally accepted and against which a comparison can be made. Standards may differ from Industry to industry.

- **Difficulties in forecasting**

  Ratios are worked out on the basis of past results. As such they do not reflect the present and future position. It may not be desirable to use them for forecasting future events.

WHAT YOU HAVE LEARNT

- The term solvency ratio means ability of a concern to meet its long-term obligations. The solvency ratios are :

  Debt-equity ratio

  Proprietary ratio

- The purpose of debt equity ratio is to derive an idea of the amount of capital supplied to the concern by the proprietary.

$$\text{Debt equity ratio} = \frac{\text{Outsiders' fund}}{\text{Shareholders' fund}}$$

$$= \frac{\text{Shareholders' fund}}{\text{Total assets}}$$

- Proprietary ratio establishes relationship between shareholders' funds to total assets of the firm

  Proprietary ratio

- Profitability ratio assesses the overall efficiency of the business concern.
- Important profitability ratios are :

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

$$\text{Net profit ratio} = \frac{\text{Net Proift}}{\text{Net sales}} \times 100$$

$$\text{Operating profit ratio} = \frac{\text{Operating proift}}{\text{Net sales}} \times 100$$

$$\text{Return on investment ratio} = \frac{\text{Net profit before interest, tax and dividend}}{\text{capital employed}} \times 100$$

- Leverage ratio establishes the relationship between various long term forms of financing such as debentures, preference share capital and equity share capital including reserves and surpluses.
- Capital gearing ratio establishes relationship between equity share capital including reserves and surpluses to preference share capital and other fixed interest bearing loans.

  Capital gearing ratio

$$= \frac{\text{Equity share capital} + \text{reserve and surplus}}{\text{Preference share capital} + \text{Long term bearing fixed interest}}$$

- Limitations of accounting ratios are
  - ignorance of price level charges
  - ignorance of qualitative factors
  - no single concept
  - misleading result if based on incorrect accounting data
  - difficulties in forecasting

TERMINAL QUESTIONS

1. Explain solvency ratios in brief.
2. What are profitability ratios? Explain the ratios in brief.
3. What are the limitations of ratio analysis?
4. What is meant by gross profit and net profit?
5. Explain capital gearing ratio.
6. From the following data, calculate (a) Gross profit ratio (b) Net profit ratio.

	Rs
Sales	25,20,000
Cost of sales	19,20,000
Net profit	3,60,000

7. Total assets Rs 12,50,000, Total debt Rs 10,00,000 current labilities Rs500,000. Calculate debt-equity ratio.

8. Following is the Profit and Loss account of M/s Bunu Ltd for the year 31st December, 2006.

Opening stock	100000	Sales	560000
Purchases	350000	Closing stock	100000
Wages	9000		
Gross profit c/d	201000		
	660,000		660,000
Administrative expenses	20000	Gross profit b/d	201,000
Salary and administrative expense	89000	Interest on investment	10000
Non-operating expenses	30000	Profit on sale of investment	8000
Net Profit	80000		
	219000		219000

You are required to calculate (a) Gross profit ratio (b) Net profit ratio (c) Operating profit ratio.

9. Following particulars pertaining to assets and liabilities of a XYZ Ltd. are given :

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Equity share capital	250000	Land and Building	450000
Preference share capital	200000	Plant	400000
Reserves	200000	Stock	150000
Debentures	300000	Sundry debtors	100000
Current liabilities	200000	Cash	45000
		Prepaid expenses	5000
	1150000		1150000

Calculate (a) debt equity ratio (b) proprietory ratio.

ANSWERS TO INTEXT QUESTIONS

Intext Questions 29.1

I. (i) $\dfrac{\text{Outsiders' funds}}{\text{Shareholders' funds}}$ (ii) Solvency

(iii) Proprietary ratio (iv) 2 : 3

Intext Questions 29.2

(i) Profitability ratio

(ii)

(iii) Fixed assets – Depreciation + current asset – current liabilities

(iv) Operating profit ratio

(v) Gross profit ratio, Net profit ratio, Return on investments, operating profit ratio

Intext Questions 29.3

(i) Capital structure (ii) Leverage

(iii) Capital gearing ratio (iv) Capital gearing

Answers to Terminal Questions

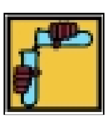
6. (a) 23.8% (b) 14.29%

$$\frac{\text{Gross profit}}{\text{Net sales}}$$

7. 2 : 1

8. (a) 35.9%, (b) 14.3% (c) 16.4%

9. (a) 1 : 1.3, (b) 1 : 1.77



Activity

Visit the office of a stock broker in the nearby market and ask annual report of two joint stock companies. Study the Banace Sheets of the two companies and compute the following ratios :

(a) Debt Equity Ratio

(b) Gross Profit Ratio

(c) Net Profit Ratio

(d) Return on investment

Compare and comment on the profitability and solvency efficiency of the two companies.