Standard Chartered

Women in Business Resource Centre

Exercise for Analysing Balance Sheets

Suppose a company shows the following Debt to Equity ratios:

Year	2009	2008	2007	2006
Debt / Equity	$ 1.75 to 1	$ 1.45 to 1	$ 1.50 to 1	$ 1.20 to 1

The owner of the company approaches a bank for an increased line of credit to finance increasing levels of inventory and accounts receivable (working capital). If the entire increase in the line of credit were drawn, the debt to equity ratio would exceed $2.00 to 1. How do you think the bank might respond to such a request? What concerns would you have about granting this increase if *you were the banker?*

Answer

The bank would be concerned about how the growth of this business is being financed. Even if the receivables were current, there is still risk to the bank. Continued growth of the debt relative to the equity position harms the ability of the owner to increase his/her leverage and increase in debt service makes the company vulnerable to changes in bank policy or reductions in growth.

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