

Balance sheet

[Business](#), [Accounting](#)



The AMR Corporation has the highest debt to equity ratio (Google, 2010). The company with the lower debt to equity ratio in the meantime is Southwest Airlines. AMR Corporation might have chosen to have a high debt to equity ratio because it believes that it can manage to experience rapid growth and sales in their business. They took on such a huge amount of debt because they believed that the interest rate would prove to be manageable and reasonable given the level of sales they will experience. AMR Corporation is very optimistic with its outlook in short.

The amount of debt the company has taken is very dangerous. It is imperative that they pay it off immediately to lower the chances of getting bankrupted in case they can't manage the monthly payments. The opposite can be said of Southwest airlines. The company is expecting lower sales volume or profit margin that is why they keep their debt levels to a minimum (Welsh, 1996). The company is well known for its cheap and no frills flight that is why they know they will have a lower profit margin. The company is trying to protect itself from any potential danger.

In the event their sales level would drop even more, the increased obligation to pay their debts would not be as heavy. This strategy is suitable for Southwest Airlines because they are providing economical flights for their passenger. The company relies on volume to make their sales and not on a high profit margin. The company does not want their thin profit margin to be eaten up by huge debt interest rates (Harvey, 1995). We can infer from the financial ratio that they intend to grow organically and not by outside financing. The debt level they have is perceived to be very manageable.

They are merely taking advantage of debt to provide a measure of added income generating assets. The bulk of their growth and capital needs would all be derived from their sales. The Continental Airlines is somewhat in between the two extreme types of companies. They are aggressive enough to take considerable debt but not too optimistic as to reach 25 in their long term debt obligation to equity. Their long term debt to equity ratio is merely 1.8 which seems small enough compared to AMR corporation. It can be inferred that the continental corporation has a moderate outlook compared to the two others.

Continental is optimistic enough to take advantage of loans to increase their coverage and business operations (Gold, 2006). They are not overly optimistic however to borrow more than twice the amount of their own equity. The economic situation has to be favorable for them to be able to pay their debts. They are not in a dangerous position however, like AMR Corporation with extreme amounts of debts. The AMR Corporation in contrast has to experience several years of extremely profitable operations in order to pay off their debt obligations.

The debt ratios of the three companies are basically indicating the same thing. The only difference with the debt ratio from debt to equity ratio is the base figure used in the denominator. The debt to equity ratio is more accurate in describing the situation of the company because it uses the actual equity invested by investors (Revsine, 2004). The ratio does not take into account the liabilities as part of the assets to be used for the computation. Naturally, the ratio for debt to equity will be bigger than the ratio using just the plain asset figure. The interpretation of the ratios remains

fundamentally the same. The meaning of the ratio is still the capability of the company to pay off its debts relative to its assets. In case of bankruptcy, the ratio indicates whether the company is capable of paying off the debt amount by selling all of its assets.