



FINANCIAL ANALYSIS

ROCE and ROE

Two ratios that set a company's profit against the money used to earn it

Index figures as on 31 August 2026

For training and education only. Not investment advice.

A profit figure means little until you know how much money was used to earn it.

ROCE sets profit against all the long-term money in the business. ROE sets it against the shareholders' money alone.

Two ratios and one building block

ROCE



Return on capital

Profit before interest and tax ÷ capital employed. What the business earns on all the money in it.

ROE



Return on equity

Profit after tax, less any preference dividend, ÷ average shareholders' equity. What is earned on the owners' money.



Capital employed

Shareholders' money plus borrowed money. One build: tangible net worth + total debt + deferred tax liability.

Shareholders' equity, or net worth, is share capital plus the profits kept in the business over time.

Source for the formulas: ICAI Guidance Note on Division II - Ind AS Schedule III, January 2022 edition, Annexure B.

Both ratios for one company

COMPANY M

Shareholders' equity ₹600 crore.
Debt ₹400 crore at 10% interest.

Profit before interest and tax ₹180 crore.

Tax at an assumed 25%.

- 1 Capital employed: ₹600 crore + ₹400 crore = ₹1,000 crore. ROCE = $180 \div 1,000 = 18\%$.
- 2 Interest: 10% of ₹400 crore = ₹40 crore. Profit before tax: $180 - 40 = ₹140$ crore.
- 3 Tax: 25% of ₹140 crore = ₹35 crore. Profit after tax: $140 - 35 = ₹105$ crore.
- 4 ROE = $105 \div 600 = 17.5\%$.

ROCE 18% is before tax, on all the capital. ROE 17.5% is after tax, on the shareholders' part.

Illustration with an invented company and assumed figures. Equity and debt taken as unchanged in the year.

Same business, different borrowing

COMPANIES P AND Q

Each uses ₹1,000 crore of capital and earns ₹180 crore before interest and tax.

P: all equity.

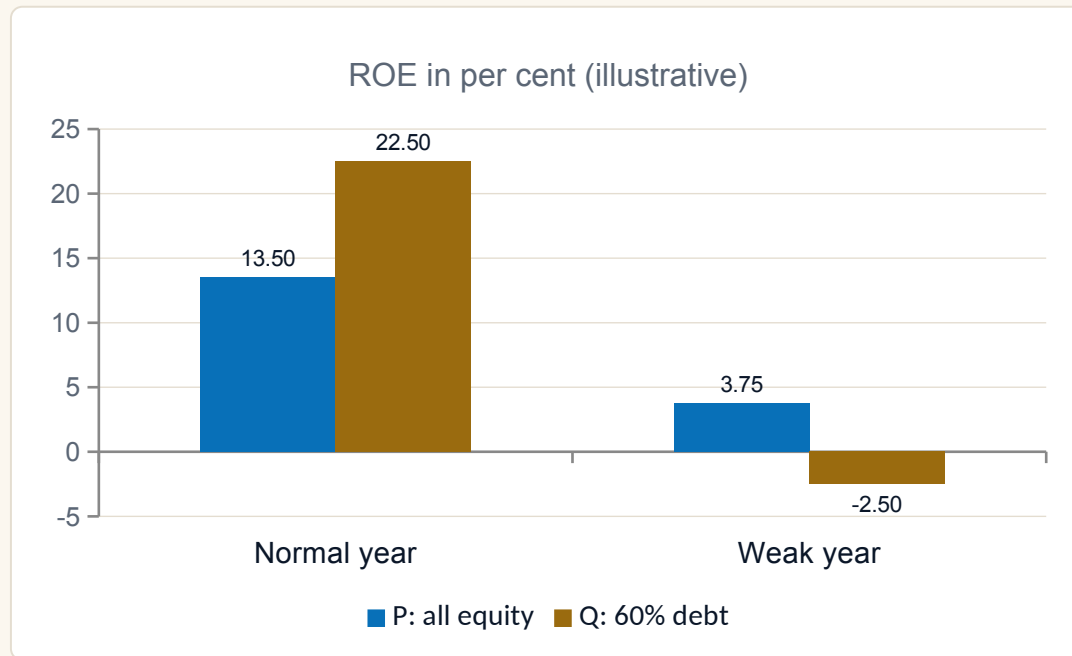
Q: equity ₹400 crore, debt ₹600 crore at 10%. Tax 25% (assumed).

- 1 ROCE is the same for both: $180 \div 1,000 = 18\%$.
- 2 P: no interest. Tax 25% of 180 = ₹45 crore. Profit after tax ₹135 crore.
ROE = $135 \div 1,000 = 13.5\%$.
- 3 Q: interest ₹60 crore. Profit before tax ₹120 crore, tax ₹30 crore, profit after tax ₹90 crore.
- 4 Q: ROE = $90 \div 400 = 22.5\%$. A smaller profit, set against a much smaller equity base.

Q's higher ROE comes from borrowing, not from a different business. ROCE shows the two are alike.

Illustration with two invented companies and assumed figures.

The same borrowing in a weak year



Read the chart

- Normal year: both earn ₹180 crore before interest and tax. Weak year: both earn ₹50 crore.
- P in the weak year: tax ₹12.5 crore, profit after tax ₹37.5 crore. $ROE = 37.5 \div 1,000 = 3.75\%$.
- Q still owes ₹60 crore of interest. $50 - 60 =$ a loss of ₹10 crore. $ROE = -10 \div 400 = -2.5\%$.

Illustration continuing companies P and Q. Assumed figures; no tax taken on the loss.

Taking ROE apart

COMPANY M AGAIN

Sales ₹1,500 crore.

Profit after tax ₹105 crore.

Total assets ₹1,200 crore.

Shareholders' equity ₹600 crore.

- 1 Profit margin: $105 \div 1,500 = 7\%$. The profit kept from every ₹100 of sales is ₹7.
- 2 Asset turnover: $1,500 \div 1,200 = 1.25$. Each ₹1 of assets produced ₹1.25 of sales.
- 3 Leverage: $1,200 \div 600 = 2$. Each ₹1 of shareholders' money supports ₹2 of assets.
- 4 $7\% \times 1.25 \times 2 = 17.5\%$. That is the ROE worked out earlier.

The same ROE can come from margin, from turnover or from borrowing. Ask which one.

Illustration with the same invented company. Sales and total assets are further assumed figures.

Before you compare two figures, ask

Question	The choices	Why it matters
Which profit?	Before interest and tax, or after tax.	ROCE is usually pre-tax and ROE post-tax. The two are not on the same footing.
What is in capital employed?	Net worth plus debt, or total assets minus current liabilities.	The same company can show different ROCE figures on different builds.
Capital on which date?	Opening, closing or the average of the two.	A large share issue or buyback in the year shifts the answer.
Anything unusual in the profit?	A one-time gain or loss in the year.	It lifts or cuts the ratio for that year only.

Companies under Divisions I and II of Schedule III (Ind AS or not) must state what they put in the numerator and denominator of each ratio they disclose.

What the indices imply

Implied return on equity = $P/B \div P/E$. Index ratios as on 31 August 2026. Approximate.

NIFTY 50

14.3%

P/B 2.92 $\div$ P/E 20.36.
About ₹14 of yearly
profit per ₹100 of net
worth.

NIFTY BANK

12.7%

P/B 1.74 $\div$ P/E 13.73.

NIFTY FMCG

24.1%

P/B 7.68 $\div$ P/E 31.93.

NIFTY IT

27.6%

P/B 5.49 $\div$ P/E 19.90.

Source: NSE Indices, daily index close file for 31 Aug 2026 (P/E and P/B). Implied return on equity is our own division, not an NSE figure.

If you learnt this from older material

What older decks say

- The reader works out ROCE and ROE from the accounts.
- Capital employed has one formula: total assets minus current liabilities.
- A ROCE of 20% or more is 'very good'.

What holds now

- Companies under Divisions I and II of Schedule III disclose both, from 2021-22.
- The company states its own numerator and denominator. Builds differ.
- A change of more than 25% from the previous year has to be explained.

There is no official pass mark for either ratio. The ratios themselves are unchanged.

Sources: Schedule III to the Companies Act, 2013, Division II (amended 24 March 2021); ICAI Guidance Note, January 2022.

Four things people get wrong



'A high ROE means a strong business.'

It can also come from heavy borrowing, or from an equity base shrunk by past losses or buybacks. Check ROCE and debt alongside.



'ROCE and ROE can be set side by side.'

ROCE is usually before interest and tax on all capital. ROE is after both, on equity alone. A gap between them is not a finding by itself.



'Above 20% is good, below is poor.'

No single mark fits all. A factory-heavy business and a services business need very different amounts of capital.



'One year's figure is enough.'

Profits of many businesses rise and fall with the cycle. Look at several years, and at what the profit was made of.

Check yourself

Q1

A company has equity of ₹500 crore and debt of ₹300 crore. It earns ₹120 crore before interest and tax. What is its ROCE?

Q2

The same company pays 10% interest on its debt and tax at an assumed 25%. What is its ROE?

Q3

A client says: 'This company has a ROE of 30%, so it must be a great business.' What would you ask first?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Formulas for return on equity and return on capital employed: ICAI Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 (Revised January 2022), Annexure B.
- Disclosure of eleven ratios, the items in each and any change of more than 25%: Schedule III to the Companies Act, 2013, Division II, as amended by notification dated 24 March 2021.
- Applies to financial years starting on or after 1 April 2021: same ICAI Guidance Note, introduction.
- P/E and P/B of Nifty 50, Nifty Bank, Nifty FMCG and Nifty IT on 31 Aug 2026: NSE Indices, daily index close file for that date. Implied return on equity computed by us.
- Companies M, P and Q and all their figures, including the 25% tax rate, are invented for illustration. They do not refer to any real company.

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