

# A Study On the Financial Leverage and Corporate Financial Performance:

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## ABSTRACT

This paper examines the relationship between financial leverage and firm performance across various industries and economic contexts. The research analyzes how debt financing influences corporate profitability, stability, and overall financial health. Through a systematic review of recent literature, the study investigates different leverage metrics and their effects on financial performance indicators such as Return on Assets (ROA), Return on Equity (ROE), and Earnings Per Share (EPS). The findings reveal that while moderate levels of financial leverage can enhance firm value and shareholder returns, excessive debt may lead to financial distress and undermine long-term sustainability. The optimal capital structure varies significantly by industry, firm size, and market conditions, suggesting that companies should tailor their leverage strategies to their specific operational characteristics and risk profile.

**Keywords:** Financial leverage, firm performance, capital structure, debt financing,

## 1. INTRODUCTION

The firm's session structure, the proportions of debt and equity used to finance the firm's assets, has implications for stockholder value. Additionally, capital structure affects leverage, which, in turn, affects the expected return and risk facing owners and creditors of the firm. This session analyzes the co-dependent leverage/capital structure phenomenon when the corporation has both fixed operating and fixed financial expenses in its cost structure.

**Capital structure** is the mixture of sources of funds a firm uses (debt, preferred stock, common stock). The amount of debt that a firm uses to finance its assets is called leverage. A firm with a lot of debt in its capital structure is said to be highly levered. A firm with no debt is said to be unleveled.

**Capital structure** can be viewed as the permanent financing the firm represented primarily by long-term debt, preferred stock, and common equity but excluding all short-term credit.

## Debt Vs Equity Financing

Financing a business through borrowing is cheaper than using equity. This is because:

1. Lenders require a lower rate of return than ordinary shareholders. Debt financial securities present a lower risk than shares for the finance providers because they have prior claims on annual income and liquidation. In addition, security is often provided and covenants imposed.
2. A profitable business effectively pays less for debt capital than equity for another reason: the debt interest can be offset against pre-tax profits before the calculation of the corporation tax bill, thus reducing the tax paid.
3. Issuing and transaction costs associated with raising and servicing debt are generally less than for ordinary shares.

There are some valuable benefits from financing a firm with debt in capital structure. One reason is financial distress risk. This could be induced by the requirement to pay interest regardless of the cash flow of the business. If the firm hits a rough patch in its business activities it may have trouble paying its bondholders, bankers and other creditors their entitlement. Relationship between Expected return (Earnings per share) and the level of gearing can be represented

## **OBJECTIVES OF THE STUDY**

- To study the Operating Leverage Position.
- To study the Financial Leverage Position.
- To study the EBIT-EPS analysis Position..
- To review the existing practices in the area of Capital – Flexibility.
- To find out the Provisions for meeting contingences.
- To find out the Leverages ratios in Industry - In times of depression

## **RESEARCH METHODOLOGY**

Financial Research has got a vital role in decision making by making available the right information, at the right time, with the right spirit, in the right place, at the right persons who involve in decision-making. Thus it is basic tool of Finance in decision making. It facilities decision making by considering the financial elements like the Collected date were presented in tables and these tables were analyzed systematically. Capital, Reserves & Surplus, Secured Loans, Unsecured Loans, Deferred tax liabilities, Fixed assets, Investment, Current Assets are the 5 Years Statistical tools like Operating Leverage, Financial Leverage, EBIT and EPS analysis used to study the capital structure performance of Aqua Designs India Limited . A chart and various diagrams are used to explain the analysis clearly. It is an undisputed truth that graphs and diagrams render any complicated discussion and any intricate subject.

### **➤ Meaning of Research:**

The term has given by AMA.

The systematic gathering, recording and analysis of data about problems relating to financial services. Such research may be undertaken by impartial agencies (or ) by business firm (or) their agencies for the solution of their financial problems and the inclusive term that embraces all research activities carried on in connection with the management of financial work.

## Sources of the Secondary data

The Sources of Secondary data includes the following:

- Profit & Loss Account.
- Balance Sheet
- Books
- Reports

### ➤ **Research Design:**

A research design is considered as the framework or plan for a study that guides as well as helps the data collection and analysis of the data. A sound research is the basis of success of any formal financial research. It is said to be the blue print of study conducted.

There are two basic type of Research Designs Viz. Exploratory and conclusive available the former helped to define the objective for the capital structure later in adopted in the study method. As the conclusive research has got two divisions, experimental or descriptive method is used here. This method as the name implies as the one designed to describe dome thing especially in user characteristic of a financial tools here the study must collect data for definite purpose.

### ➤ **TOOLS USED FOR RESEARCH DESIGN:**

The following tools are used in the company analysis of capital structure of the company.

- Operating Leverage
- Financial Leverage
- Combined Leverage
- EBIT- EPS Analysis

### ➤ **DATA COLLECTION**

The study is based on secondary source of data. Secondary data have been mainly obtained from annual reports, records and books of Aqua Design limited. The secondary data were also collected from audited financial statements periodicals and other records maintained.

## 2. Literature Review

**Ramesh (2022).** The trade-off theory of capital structure posits that firms determine their optimal debt level by balancing the benefits of debt financing against the costs of financial distress and bankruptcy. According to this framework, companies increase their leverage until the marginal benefits of additional debt equal the marginal costs associated with higher financial risk .The primary advantage of debt financing comes from the tax shield effect, as interest payments are tax-deductible, effectively reducing a firm's tax liability and increasing its after-tax cash flow. Additionally, debt can serve as a disciplining mechanism that mitigates agency costs by constraining managers' discretionary spending and encouraging operational efficiency.

**Jeevan Kishore(2023)**-However, the trade-off theory recognizes that as a firm's leverage ratio increases, so does its financial risk, leading to higher probabilities of financial distress and bankruptcy. These increased risks manifest in various ways, including higher borrowing costs, reduced financial flexibility,

and potential underinvestment in profitable projects due to debt overhang. In volatile economic environments or industries characterized by significant operational uncertainty, the costs of financial distress can quickly outweigh the benefits of the tax shield, suggesting that firms in such contexts should maintain lower debt ratios.

**DATA ANALYSIS AND INTERPRETATION**

**Table-1-Capital**

Year	Capital
2020-21	1021.57
2021-22	1021.57
2022-23	1021.57
2023-24	1050.64
2024-25	1050.64

**INTERPRETATION**

From the above table, it is clear that there are no changes in the capital of the company, from the year 2020-2021 to 2022-2023. It as been increased during the year 2022-2023 from 1021.57 Cores to 1050.64 Cores, again there is no changes in the capital during the year 2024-2025.

**Table-2-Reserves & Surplus**

Year	Reserves & Surplus
2020-21	18934.78
2021-22	17152.48
2022-23	20308.62
2023-24	22240.50
2024-25	27148.38

**INTERPRETATION**

It is observed from the table, which the reserves & surplus slightly decrease from the year 2020 – 2021 to 2021-2022. It has been increased during the year 2022-2023 from 17,152.48 Cores to 20,308.62 Cores, again there is the changes 2023-2024 and 2024-2025.

**Table-3-Secured Loans**

Year	Secured Loans
2020-21	4116.23
2021-22	2082.74
2022-23	2597.33
2023-24	13970.15
2024-25	12953.08

**INTERPRETATION**

Table shows secured loans are major changes & decrease in the year 2020-2021 to 2021-2022. From 4116.23 cores to 2082.74. It has been increasing the year 2022-2023 and 2023-2024 from 2597.33 to 13,970.15.

**Table-4 - Unsecured Loans**

Year	Unsecured Loans
2020-21	9217.71
2021-22	9651.50
2022-23	6906.31
2023-24	7783.96
2024-25	19102.89

**INTERPRETATION**

It is clear from the above table, that there are no changes in the unsecured loans of the company, from the year 2020-2021 to 2021-2022. It has been increasing during the year 2023-2023 to 2024-2025 from 6906.31 lakhs to 19,102.89. lakhs.

**OPERATING LEVERAGE**

Operating leverage occurs when the firm has fixed operating expenses in its cost structure serves to magnify a given a percentage change in sales in to a larger and percentage change in EBIT.

$$DOL = \frac{\% \text{ Change In EBIT}}{\% \text{ Change In SALES}}$$

$$\begin{aligned} \text{For the Year: } 2024-25 &= \frac{5,370.00}{42,421.25} \\ &= 0.126 \end{aligned}$$

**FINANCIAL LEVERAGE**

The procedure outlined below is merely indicative of the presence or absence of financial leverage. Financial leverage can be more precisely expressed in terms of the degree of financial leverage

$$DFL = \frac{\% \text{ Change In EPS}}{\% \text{ Change In EBIT}}$$

$$2.81$$

$$\begin{aligned} \text{For the Year: } 2024-2025 &= \frac{\text{-----}}{5,370.00} \\ &= 0.00052. \end{aligned}$$

### COMBINED LEVERAGE

The operating leverage has its effects on operating risk and is measured by the percentage change in EBIT due to percentage change in sales. The financial leverage has its effects on financial risk and is measured by the percentage changes in EPS due to percentage change in EBIT. Since both these leverages are closely concerned with ascertaining the ability to cover fixed charges if they are combined the result is total leverage and the risk associated with combined leverage is known as total risk.

$$\text{DCL} = \text{Degree of Operating Leverage} \times \text{Degree of Financial Leverage.}$$

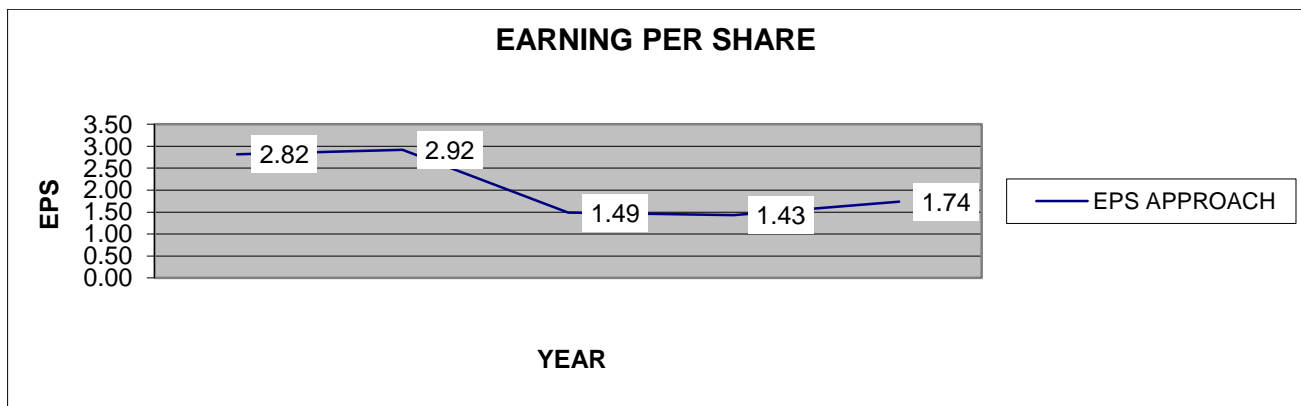
$$\begin{aligned} \text{For the Year: } 2024-2025 &= 0.126 \times 0.00052 \\ &= 0.000065. \end{aligned}$$

### EBIT – EPS APPROACH

						(Rs.in.lacs)
		2020-21	2021-22	2022-23	2023-24	2024-25
	SALES	42,421.25	38,302.38	45,882.69	68,911.58	92,954.85
<b>LESS:</b>	Operating Expenses (Interest)	38,723.25	34,209.38	39,255.69	60,113.58	82,675.85
	Profit Before Tax	3,698.00	4,093.00	6,627.00	8,798.00	10,279.00
<b>LESS:</b>	Tax	820.00	1,172.00	2,088.00	3,008.00	3,339.00
	Profit After Tax	2,878.00	2,921.00	4,539.00	5,790.00	6,940.00

<b>LESS:</b>	Dividend	61.28	0.00	58.52	55.23	0.00
	Equity.Sh.Hold	2,816.72	2,921.00	4,480.48	5,734.77	6,940.00
	Trfd .to Gen.Res	1,000.00	1,000.00	3,000.00	4,000.00	4,000.00
	<b>EPS</b>	<b>2.82</b>	<b>2.92</b>	<b>1.49</b>	<b>1.43</b>	<b>1.74</b>

**EARNING PER SHARES – APPROACH**



**INTERPRETATION**

From the above table we can observe that EPS as been Decrease –2.82 lacs to 1.74 lacs. This Shows that the company his depending on Equity Share Capital. It shows clearly that the Major way of increasing the capital is through Debentures (or) borrowing Loan from financial Institutions. This helps the company to maintain or its Increase in EPS.

**FINDINGS AND CONCLUSIONS**

**FINDINGS OF THE STUDY**

The following findings are made after the analysis of the Capital Structure

- It has been inferred that the capital increasing for the past 3 consecutive years. Loan can be suddenly increased in the past 3 years.

- To find out the Operating, Financial, combined Leverages and EBIT and EPS approach
- The company is maintaining the proper measures to maintain the current assets.
- The company should take necessary action to increase the EPS
- The company should concentrate in the Importance of equity as well as debt.
- To find out the major findings of the Capital, Loan, and due to purchase of the fixed asset
- The company should also raise the funds through debentures or borrowing loans from Financial institutions.
- The company should try to avoid Excessive Investment in the major sources.
- The union and management should work more objectively to achieve effective utilization of the capital structure.
- The unsecured loans also increase for the 5 years.
- Current assets of the company are not satisfactory.
- EBIT –EPS it has been decrease 2.82 to 1.74 this shows the company his depending on Equity. Share capital.

### 3. CONCLUSION

The Determinants of Capital Structure summarize that is has yield a satisfactory performance in terms of Capital, Loan, due to Purchase of fixed assets, and deferred tax liability, secured loan, and Unsecured Loans Current assets, and current liability, Reserves & surplus for all the Five years taken for the study. The analysis under all the methods shows good performance of the company

They are not importance of Debt And Equity funds which is not much satisfied and more importance of the Capital Structure, EBIT, EPS, Operating ,Financial, Combined leverages, which are mainly used for the tools of the Project..

Therefore, the company should concentrates proper measures to maintain the current assets, and used for the importance tools were used for the company. Adequate provision can be made in the investments for raising the funds, company may also exploit export offer to popularize the product. It should maintain the following EPS it has been decrease thus shows that the company is depending on Equity share capital it shows clarify that the major way of increasing the capital is through debentures and borrowings loan from Financial Institutions, this helps the company to maintain or its increases in EPS .

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