Financial Leverage Determinants on the Financial Performance of a Company

A V N Murthy, N Konda Reddy, S Ragamayi

Abstract: The focus of the researchers is to examine the relationship between different financial leverage ratios like profitability, tangibility, growth and size to know the strength of the variables to justify financial performance of the company. The study is based on the secondary source of information collected from annual reports, websites, RBI bulletins, money control and CMIE reports. It is understood that the financial ratios are the strength of the financial performance assessment of a company for particular period of time which can be done through a well defined and designed research methodology basing on the facts and figures.

Keywords: Leverage, determinants, Capital Structure, Debentures, Long term goals

I. INTRODUCTION

Meaning: The concept of financial leverage indicates and signifies the composition of the size of the capital. Capital includes equity and debt very strong capital is the basis of existence of a company. Depending on this the companies can plan for long term and short term goals. The company will be in position to define its objectives and clearly state the procedure and practice to achieve it. Different companies follow and adopt different theories for determining the size and composition of the capital. This will help in procurement of long term assets through long term founding from different sources either from the capital market or from the financial institutions.

Definition: Capital structure of a company is a combination of debt and equity.

The FMCG sector in recent times has been one of the largest contributing sectors to the Indian economy. This sector has a very good share as per as US market is concern in different products and product line.

Capital is the strength of the company having a very good composition of external equity and debt that enables the company with a better credit rating for long term borrowings and investment decision in assets and liabilities so as to generate better profit that will enable the company to decide upon sound dividend policy.

II. REVIEW OF LITERATURE

Dr. Rohith R. Manjule, the researcher in his article as examine the factors like increase in return on investment is very often negative component of debt to equity ratio. It is clearly observed there is no association between debt equity and operating earnings which signifies that there are less chances of bankruptcy. It is also observed that financial performance also depend upon the type of industry operating in the economy. The author has taken a set of secondary source data and applied statistical tools to validate the significance of the financial performance.

Vinod Bhatnagar, the researcher in his research has focused on the need for good composition of capital of a company. It is an observation that the good capital structure attracts the stake holders and share holders to earn good percentage of profit after meeting different types of costs. Companies always try to influence BSE and NSE for rating performance.

Rosy Dhingra, the focus of the author was on the importance of a sound capital structure particularly in iol industry. The authors have focused on the important variables like profitability, tangibility, risk and solvency. The data was collected on the secondary source and duration of the study was 10 years with a vefry good research design and calculation of ratios to prove the strength of oil industry.

S.Sathyanarayana, the observation of the author in his research article was that most of the vibrant sectors of Indian and global economy have been focusing on strong capital base. This will enable the companies to be a long term national and global player.

Patrik Ogebe, the author has made research to justify the business environment prevailing in Nigeria. The author has selected the macro-economic variables to prove a financial performance of the companies should not be under any circumstances fall below 10 percent. It is the practice of the decision makers in Nigerian companies to focus on strong capital adequacy and excellent performance. The author felt that a strong capital size of the company will make the company's strong in a performance.

Saurabh chada, the idea of the author in this paper was to assess a good combination of capital structure components to balance between long term and short term financial obligation settlements by the firms. The author focused on a period of 10 years and selected those companies which were listed in BSE. E view statistical software was used to make regression analysis. Abdul Basith, the researcher have particularly focused upon the companies listed in the Newzeland Stock Exchange and what were the components used by the earlier researchers to determine a strong capital structure of the company.

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The author tried to establish between the relationship between the variables basing upon the pecking theory as a base for the study.

Denis Forte; Lucas ayres barros, the author selected small and medium size industries in Brazil to prove the importance of capital adequacy for good financial performance. The author also focused upon the dynamic nature of leverage ratios to examine the financial performance of the companies.

III. RESEARCH DESIGN

The basic need for any research is the methodology that is being adopted for validating the purpose and objective of the research. Research design lays a clear path of systematic and scientific procedure for undertaking the research process. It enables to know the researcher the correct procedure to follow the research activity.

Objective:
1. To develop new ideas
2. To test the assumption
3. To analyze the result of the test to justify the significance

Hypothesis

H_0: There is no significant relation between the determinants of capital structure and financial leverage.

Variables

Dependent variable: Financial performance

Independent variables:
- Profitability
- Growth of the firm
- Size of the firm
- Tangibility

Data: The study was based on secondary data of selected firms the data was collected from the company's financial statements of past 17 years.

Sampling Technique: Purposive

Sample size: Four companies (17 years data)

Tools used: Linear regression & Correlation

IV. ANALYSIS OF THE STUDY

While checking the correlation between the independent variables of all the companies it is observed that there is very least correlation hence I have performed linear regression.

I. ITC

		Size of the firm	Tanzibility	Growth rate	Probability	FI
Size of the firm	correlation coefficient / Sig. (2 tailed) / N	1 / / 17	0.514* / 0.035 / 17	0.216 / 0.025 / 17	0.541* / 0.025 / 17	-0.673** / 0.003 / 17
Tanzibility	correlation coefficient / Sig. (2 tailed) / N	0.514* / 0.035 / 17	1 / / 17	0.239 / 0.355 / 17	0.171 / 0.511 / 17	-0.282 / 0.273 / 17
Growth rate	correlation coefficient / Sig. (2 tailed) / N	-0.216 / 0.405 / 17	0.239 / 0.355 / 17	1 / / 17	-0.482 / 0.050 / 17	0.148 / 0.570 / 17
Probability	correlation coefficient / Sig. (2 tailed) / N	0.541* / 0.025 / 17	0.171 / 0.511 / 17	-0.482 / 0.050 / 17	1 / / 17	-0.471 / 0.056 / 17
FI	correlation coefficient / Sig. (2 tailed) / N	-0.673** / 0.003 / 17	-0.282 / 0.273 / 17	0.148 / 0.570 / 17	-0.471 / 0.056 / 17	1 / / 17

II. DABUR

		Size of the firm	Tanzibility	Growth rate	Probability	FI
Size of the firm	correlation coefficient / Sig. (2 tailed) / N	1 / / 18	0.211 / 0.400 / 18	0.298 / 0.245 / 17	-0.199 / 0.430 / 18	-0.399 / 0.101 / 18
Tanzibility	correlation coefficient / Sig. (2 tailed) / N	0.211 / 0.400 / 18	1 / / 18	0.275 / 0.286 / 17	0.673** / 0.002 / 18	-0.853** / 0.000 / 18
Growth rate	correlation coefficient / Sig. (2 tailed) / N	-0.298 / 0.245 / 17	0.275 / 0.286 / 17	1 / / 17	-0.564* / 0.018 / 17	-0.167 / 0.521 / 17
Probability	correlation coefficient / Sig. (2 tailed) / N	-0.199 / 0.430 / 18	0.673** / 0.002 / 18	-0.564* / 0.018 / 17	1 / / 18	-0.548* / 0.019 / 18
FI	correlation coefficient / Sig. (2 tailed) / N	-0.399 / 0.101 / 18	-0.853** / 0.000 / 18	-0.167 / 0.521 / 17	-0.548* / 0.019 / 18	1 / / 18

III. HUL Correlations

		Size of the firm	Tanzibility	Growth rate	Probability	FI
Size of the firm	correlation coefficient / Sig. (2 tailed) / N	1 / / 18	0.423 / 0.080 / 18	-0.656** / 0.004 / 17	0.216 / 0.389 / 18	0.230 / 0.359 / 18
Tanzibility	correlation coefficient / Sig. (2 tailed) / N	0.423 / 0.080 / 18	1 / / 18	-0.590* / 0.013 / 17	-0.814** / 0.000 / 18	0.471* / 0.049 / 18
Growth rate	correlation coefficient / Sig. (2 tailed) / N	-0.656** / 0.004 / 17	-0.590* / 0.013 / 17	1 / / 17	0.224 / 0.387 / 17	-0.114 / 0.664 / 17

Probability	correlation coefficient Sig. (2 tailed) N	0.216 0.389 18	-0.814** 0.000 18	0.224 0.387 17	1 18	-0.500* 0.035 18	
FI	correlation coefficient Sig. (2 tailed) N	0.230 0.359 18	0.471* 0.049 18	-0.114 0.664 17	-0.500* 0.035 18	1 18	

		0.768 -0.161	0.311 0.072	-0.651		2.469 -2.237	0.030 0.045
1	(constant) Size of the firm						
	Tanzibility Growth rate Probability	0.165 0.207 0.389	0.392 0.478 0.557	0.113 -0.112 -0.193		0.421 0.434 0.698	0.681 0.672 0.498

IV. NESTLE Correlations

		Size of the firm	Tanzibility	Growth rate	Probability	FI
Size of the firm	correlation coefficient Sig. (2 tailed) N	1 17	0.174 0.505 17	-0.422 0.103 16	-0.096 0.714 17	0.326 0.202 17
Tanzibility	correlation coefficient Sig. (2 tailed) N	0.174 0.505 17	1 17	-0.477 0.062 16	-0.475 0.054 17	0.619** 0.008 17
Growth rate	correlation coefficient Sig. (2 tailed) N	-0.422 0.103 16	-0.477 0.062 16	1 16	0.260 0.330 16	-0.148 0.585 16
Probability	correlation coefficient Sig. (2 tailed) N	-0.096 0.714 17	-0.475 0.054 17	0.260 0.330 16	1 17	-0.024 0.928 17
FI	correlation coefficient Sig. (2 tailed) N	0.326 0.202 17	0.619** 0.008 17	-0.148 0.585 16	-0.024 0.928 17	1 17

**. Correlation is significant at the 0.01 level (2-tailed)

Multiple Regression (ITC ltd): All the determinants Size of the firm, Tangibility, Growth rate, Profitability together Influence 48% on Capital Structure of ITC ltd.

In my observation I observed that only size of the firm is influencing the capital structure of ITC ltd.

Other determinants tangibility, growth rate, profitability are not influencing capital structure of ITC ltd.

I. ITC - Model Summary

Model	R	R Square	Adjusted R Square	Standard Error
1	0.693[a]	0.481	0.308	0.1028365

a. Predicators: (Constant), Profitability, Tanzibility, Growth Rate, Size of the firm.

ANOVA[a]

Model		Sum of Squares	df	Mean Squares	F	Significant
1	Regression Residual Total	0.117 0.127 0.244	4 12 16	0.029 0.011	2.777	0.076[b]

Coefficients[a]

Model		Unstandardized coefficients		standardized coefficients	t	Significant
		B	Std Error	Beta		

II. NESTLE - Model Summary

Model	R	R Square	Adjusted R Square	Standard Error
1	0.771[a]	0.595	0.448	0.5746

a.

ANOVA[a]

Model		Sum of Squares	df	Mean Squares	F	Significant
1	Regression Residual Total	5.335 3.632 8.967	4 11 15	1.334 0.330	4.039	0.030[b]

Coefficients[a]

Model		Unstandardized coefficients		standardized coefficients	t	Significant
		B	Std Error	Beta		
1	(constant) Size of the firm	-3.248 0.626	1.329 0.400	0.332	-2.444 1.556	0.033 0.146
	Tanzibility Growth rate Probability	2.434 2.498 0.001	0.670 1.850 0.000	0.871 0.320 0.337	3.632 1.350 1.543	0.004 0.204 0.151

III. HUL- Model Summary

Model	R	R Square	Adjusted R Square	Standard Error
1	0.637[a]	0.406	0.208	0.477891

ANOVA[a]

Model		Sum of Squares	df	Mean Squares	F	Significant
1	Regression Residual Total	0.876 2.741 4.616	4 12 16	0.469 0.228	2.053	0.150[b]

Coefficients[a]

Model		Unstandardized coefficients		standardized coefficients	t	Significant
		B	Std Error	Beta		
1	(constant) Size of the firm	-8.113 2.238	5.411 1.477	0.452	-1.500 1.515	0.160 0.156

Tanzibility	0.878	0.912	0.538		0.962	0.355
Growth rate	1.923		0.515		1.328	0.209
Probability	0.079	1.449	0.070		-0.151	0.882
		0.521				

IV. DABUR - Model Summary

Model	R	R Square	Adjusted R Square	Standard Error
1	0.880[a]	0.775	0.700	0.83159

ANOVA[a]

Model		Sum of Squares	df	Mean Squares	F	Significant
1	Regression	0.286	4	0.072	10.341	0.001[b]
	Residual	0.083	12	0.007		
	Total	0.369	16			

Coefficients[a]

Model		Unstandardized coefficients		standardized coefficients	t	Significant
		B	Std Error	Beta		
1	(constant)	1.214	0.207		5.857	0.000
	Size of the firm	-0.119	0.067	-0.264	-1.763	0.103
	Tanzibility	-0.720	0.217	-0.740	-3.312	0.006
	Growth rate	0.026	0.283	0.016	0.093	0.928
	Probability	0.096	0.234	0.104	-0.410	0.689

a. Dependent Variable: FI

V. CONCLUSION

- It is very clear from the observation of the study that financial determinants have an influence on the financial performance of the company.
- The sector selected for the study is from FMCG which is very vibrant sector in the economy.
- The independent variables used to predict the influence on the dependent variable i.e., financial performance.

It can be concluded that the factor of financial leverage has greater influence in predicting the accuracy of financial performance.

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