

IMPACT OF FINANCIAL LEVERAGE ON SHAREHOLDERS RETURNS OF TATA MOTORS INDUSTRY

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Abstract: Financial leverage measures firm's that exposure to the money risk. The high level of the money leverage agree the shareholders to gain a high come back on equity, but they are also exposed to get a higher risk of significant loss, if they come back on assets is lower. The money leverage used by the firm is planned to earn additionally on the mounted charges funds than their relative price. Where Market capitalization represents the collection value of the company or stock. It can be obtained by multiplying the number of shares outstanding by their current price per share. The present study explores the effect of money leverage on shareholders' return and market capitalization of automobile company of Tata Motors limited, India. Simple linear regression analysis was carried out to judge the impact of financial leverage on shareholders' return and market capitalization independently to find out the state of influence of the leverage. Further, discussion was held to find out the probable causes of the findings opening the new avenues of research.

Keywords: Financial Leverage, Shareholder's Return, Market Capitalization.

Introduction: The term company leverage decision centers on the allocation between debt and equity in company. However, how the leverage of the company is determined in a world in which cash flows are uncertain and in which capital can be obtained by many different media ranging from the pure debt instruments to the pure equity instruments is an unsettled issue. A number of the researchers have been attempted to understand the financing choices of the firm and to identify the effect of changes in financial structure on the WACC of the firm and its value.

The Common ratios where as debt-to-total capital or debt-to-equity quantify this relationship. The importance of leverage in the capital structure of the company is that its efficient use reduces the weighted average cost of capital (WACC) of the company. Where lowering the cost of capital increases the net economic returns also, ultimately increases firm value.

The leverage of a firm is basically related to a profit measure which may be a return on investment or on earnings before taxes. Leverage is an advantage or disadvantage which is derived from earning a return on total investment (total assets) and which is different from return on owner's equity. It is the relationship between the both equity share capital and securities and creates fixed interest and dividend charges.

In simple terms, leverage is the advantageous condition of having a relatively small amount of cost yield a relatively high level of returns.

Financial leverage:

'Leverage refers to the use of fixed cost in an attempt to increase (or lever up) profitability'.

- In the words of **J. E. Walter**, 'Leverage may be explained as percentage return on equity and the net rate of return on total capitalization'.
- **Ezra Solomon** determines leverage as 'the ratio of net returns on shareholders equity and the net rate of return on total capitalization'.

According to **S. C. Kuchhal**, the term leverage 'is used to decide a firm's capacity to use fixed cost bearing assets or funds to enlarge the return to its owners'

EBIT in the context of financial leverage

To finance its operations, a corporation increase capital by borrowing money or selling shares of company ownership to the public. The corporation can only remain viable if it creates sufficient earnings to offset the costs associated with its financing – after all, some of its revenue needs to be paid out to stockholders, bondholders and other creditors. The composition of a corporation's financing plans has a significant impact on how much operating income it needs to generate.

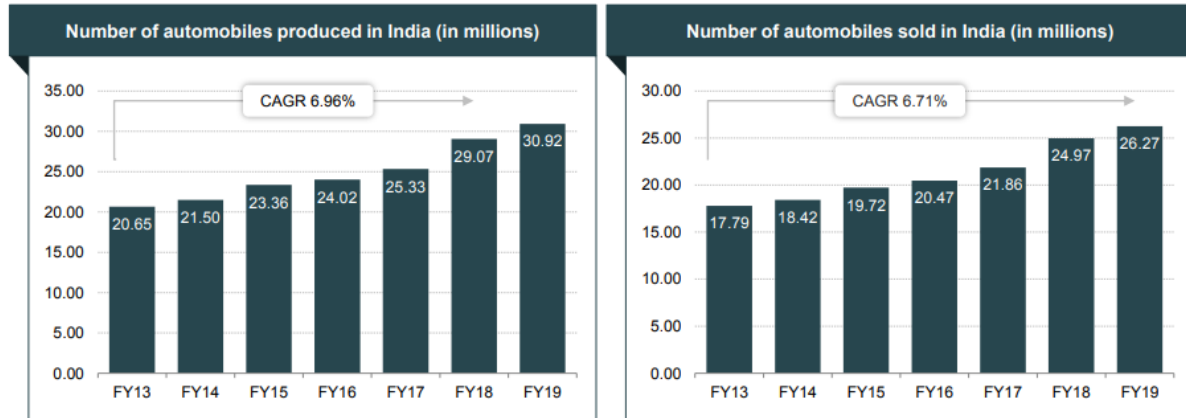
Objectives: To study the financial leverage practise of the company by using the different methods like EBIT, EAT, DFL, and also know the relation between leverage and share holders of the Tata company.

Research Methodology: secondary data is used for the present study. The data has been collected for the period 2015-2019. Data is related analyse the financial leverage practise of the company .By using

- Brochures
- Websites
- Literature reviews
- Articles
- Journals

Company Profile

The car (TATA) industry in India is world's fourth biggest, with in the nation at present being the world's fourth biggest maker of vehicles and seventh biggest producer of business vehicles in 2018. The car business (counting segment producing) is required to arrive at Rs 16.16-18.18 trillion (US\$ 251.4-282.8 billion) by 2026. Bikes overwhelm the organization made up 81 percent share in the homegrown car deals in FY19. The deals of homegrown car in India has expanded at 6.71 percent CAGR between FY(13-18) with 26.27 million vehicles being sold in FY19. It has gotten Foreign Direct Investment (FDI) worth Rs 1,49,424 crore (US\$ 22.35 billion) between April 2000 and June 2019, where 5% of all out FDI inflows to India from the April 2000 to June 2019 went into the car area.



The Indian government has additionally set up a decided objective of having just electric vehicles being sold in the nation. Indian car industry is anticipate to see 8-12 percent expansion in its recruiting during FY19. The Ministry of gigantic Industries, Government of India has shortlisted 11 urban communities in the nation for presentation of electric vehicles (EVs) in their public vehicle frameworks under the FAME (The Faster Adoption and Manufacturing of (Hybrid) and Electric Vehicles in India) conspire. The main period of the plan has been reached out to March 2019 while In February 2019, the Government of India affirmed the FAME-II conspire with an asset prerequisite of Rs 10,000 crore (US\$ 1.39 billion) for FY20-22. Number of vehicles bear under FAME conspire has expanded to 192,451 units in March 2018 from 5,197 units in June 2015. On July 29, 2019, Inter-ecclesiastical board has authorized 5,645 electric transports for 65 urban communities.

Degree of Financial Leverage

Formula for calculating Degree of Financial Leverage:

Definition: The degree of financial leverage (DFL) is the leverage ratio that sums up the effect of an amount of financial leverage on the earning per share, of a company. The degree of financial leverage or DFL makes use of fixed cost to provide finance to the firm and also comprise the expenses before interest and taxes. If the Degree of Financial Leverage is high, then the Earnings Per Share or EPS would be more uncertain while all the other factors would remain the same.

$$DFL = \% \text{ Change in EPS} / \% \text{ Change in EBIT.}$$

Where EPS is the Earnings per Share and EBIT is the Earning before interests and taxes.

Accounting Return on Investment and Financial Leverage:

Risk, return, and financial leverage: Risk and return are interrelated concepts important in both accounting and finance. Authors have survey alternative measures of risk and return both market-based and financial-statement based in numerous studies in finance and accounting. Most books on financial statement analysis and security evaluation list risk and return as main areas of analysis. Bernstein (1993,652) states the case as follows.

A firm's debt-to-equity ratio that also impacts the firm's borrowing costs and its value to shareholders. The debt-to-equity ratio is a measure of a company's financial leverage which can be calculated by dividing its total liabilities by stockholders' equity. It indicates the proportion of equity and debt the company issuing to finance its assets.

$$= \text{Total liabilities} / \text{shareholders equity}$$

Impact of Financial Leverage on Performance:

It can be calculated using the following equation:

$$ROE = \text{NET Income (After Tax)} / \text{shareholder equity}$$

'Debt/Equity Ratio'

The formula can be calculated as follows:

$$\text{Debt - Equity Ratio} = \text{Total Liabilities} / \text{Shareholders' Equity}$$

The result may often be expressed as a number or as a percentage.

$D/E = \text{Total Liabilities} / (\text{Total Assets} - \text{Total Liabilities})$

Data Analysis and Interpretations:

Computation of EBIT, EBT, EAT of Tata company

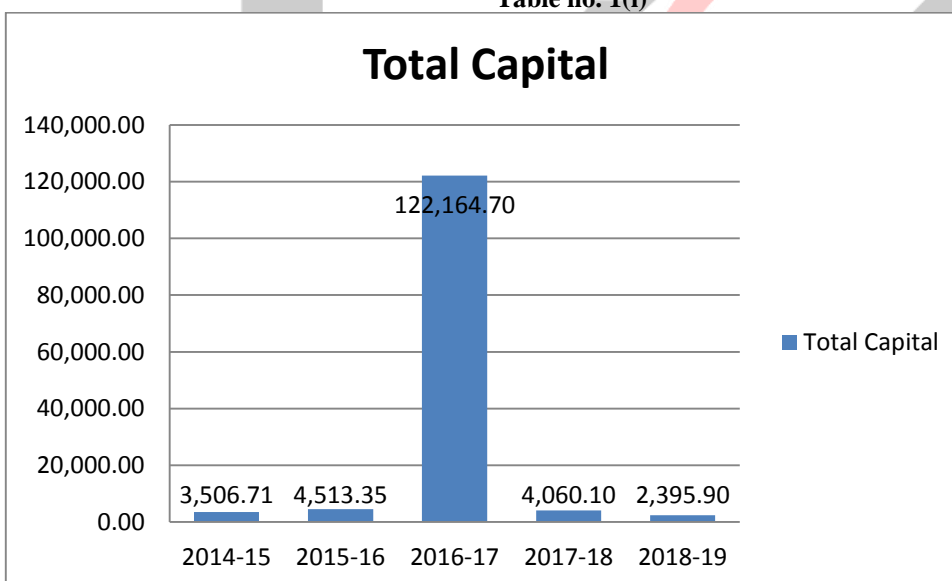
Years	Total Capital	Long term employed	Equity Share Capital	Reserves & Surplus	Net worth	EBIT	Interest	EBT	EAT
2014-15	679.22	12,318.96	643.78	14,218.81	42,345.39	-2014.56	2,602	-3974.72	160.61
2015-16	679.18	10,599.96	679.18	20,483.39	43,340.62	-2014.56	3,156	155.81	-2429.60
2016-17	679.22	13,686.09	679.22	19,491.76	57,441.05	19.74	3,546	-2,353.27	-1,034.85
2017-18	679.22	13,155.91	679.22	21,483.30	68,764.88	2602.00	3,696	-946.92	2,020.6
2018-19	719.0	13,914.74	719.0	16,800.61	43,485.76	-4616.42	3,826	2398.93	-7289.63

Source: The data is collected from Tata Company.

Total Capital = [fixed assets + current assets-(Loans & advances)] –current liabilities

Year	fixed assets	Current assets	Loans & advances	Current liabilities	Total capital
2014-15	10,599.96	11,861.69	252.93	18,701.74	3,506.71
2015-16	13,686.09	12,757.07	391.46	21,538.35	4,513.35
2016-17	13,155.91	14,971.66	143.96	24,218.95	122,164.7
2017-18	13,914.74	13,229.30	143.13	22,940.81	4060.1
2018-19	14,776.51	13,568.76	138.46	25,810.82	2,395.9

Table no. 1(i)



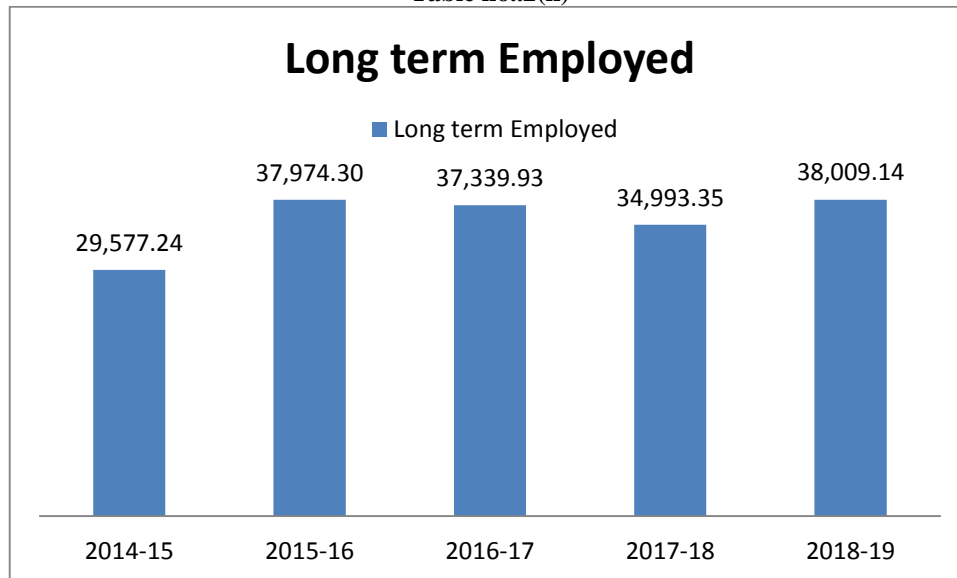
Source: Author's calculations

Interpretation: From the above it is observed that due to the fluctuations in company's assets and liabilities, the total capital of the company is decreased from 2016-17 to 2015-16 and increased in the year 2016-17, and again decreased from the year 2015 to 2019.

1(ii) Long term Employed =Share Capital + Reserves & surplus + secured loans

Year	Share capital	Reserves& surplus	Secured loans	Longterm employed
2014-15	648.78	14,218.81	14,709.95	29,577.24
2015-16	679.22	22,582.93	14,712.15	37,974.3
2016-17	679.22	20,483.39	16,177.32	37,339.93
2017-18	679.22	19,491.76	14,822.37	34,993.35
2018-19	719.54	21,483.30	15,806.30	38009.14

Table no..2(ii)



Source: Author's calculations

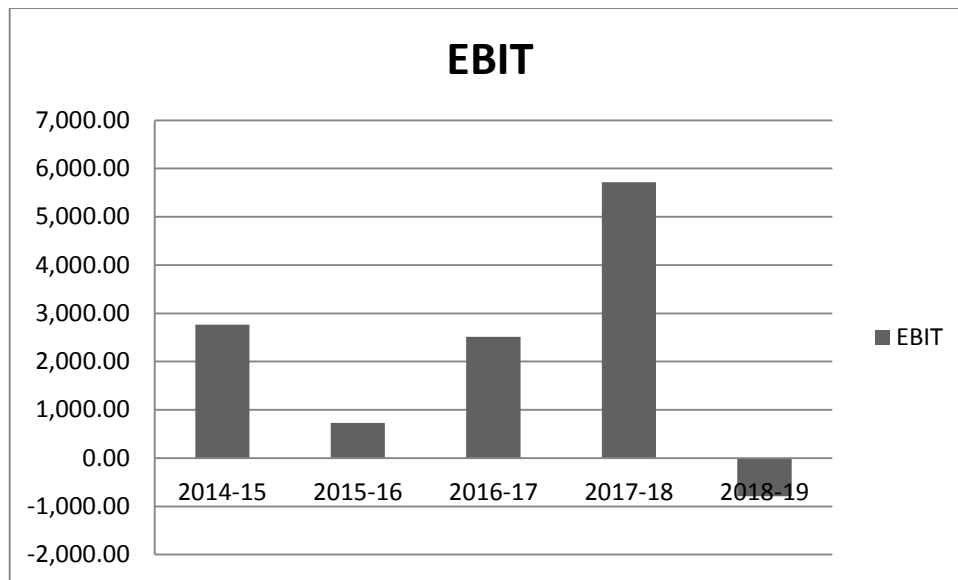
Interpretation: From the above table it is observed that due to the fluctuations in the values of share capital, reserves & surplus and secured loans, the company's long term employed is increased from 2015-16 and decreased in the year 2017-18, and again increased from the year 2018 to 2019.

EBIT = EBT + Interest:

EBIT is a measure of a firm's profit that excludes all the expenses except interest and income tax expenses. It is the difference between operating revenues and operating expenses. When a firm does not have non-operating income, then operating income is sometimes used as a synonym for EBIT and operating profit.

Year	EBT	Interest	EBIT
2014-15	160.61	2,602	2,762.61
2015-16	-2429.60	3,156	726.4
2016-17	-1,034.85	3,546	2,511.15
2017-18	2,020.60	3,696	5716.6
2018-19	-4616.42	3,826	-790.42

Table no. 1(iv)

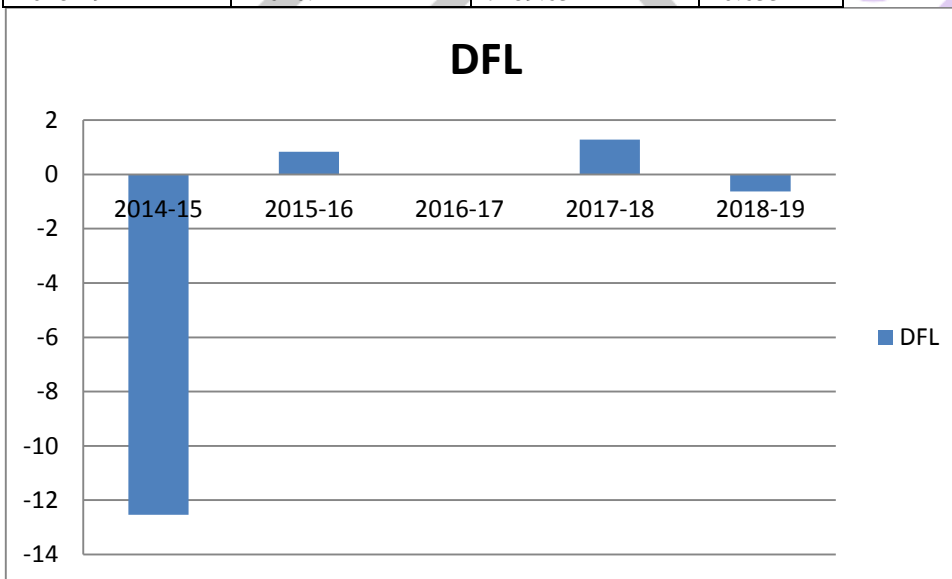


Source: Author’s calculations

Interpretation: From the above table it is observed that as the value of Earnings Before Tax has increased from the year 2014-15 and then gradually decreased from the year 2015-16. And the value of interest payments to the debenture holders has been gradually increased from the year 2017-18. and With the changes in the values of EBT & Interest, the value of EBIT has decreased from the year 2018-19.

Degree of financial leverage=(DFL)=EBIT/EBT

Year	EBIT	EBT	DFL
2014-15	-2014.56	160.61	-12.54
2015-16	-2014.56	-2429.60	0.829
2016-17	19.74	-1,034.8	-0.019
2017-18	2602.00	2,020.60	1.287
2018-19	-4616.42	7289.63	-0.633



Source: Author’s calculations

Interpretation: From the above table it is observed that. The value of Degree of Financial Leverage (DFL) is decreased totally from the year 2014-15 and then increased from the year 2017-18 and again gradually decreased in the year 2018-19.

Findings:

- Equity capital remains constant from the year 2014-18 and increased from the year 2018-19 because the shares has been issued.
- And the company conducted its operations by raising long term debt.
- EPS has shown decreasing trend all through the period of the study.
- For the years 2017-18& 2018-19 the DFL of is 1.287.It represents that firm is in profits. And in the year 2018-19 the DFL is -0.633. it is less than 1% so the firm is in losses.
- The financial leverage practice of the company is not proper.
- The rate of Rate of Interest has shown an increasing trend in the year 2017-18 and decreased in the year 2018-19.
- The company’s rate of return on investment has gradually decreased in the year 2015-16 i.e., (-53.83) and again increased in the year 2017-18 and decreased in the year 2018-19.which represents that the firm has not incurred earnings.

Conclusion:

Every concern has the aim to frame the optimum capital structure to its business as maximising to its business as maximising the firm and minimising the cost of the capital. The study has concluded that the optimum capital structure of Tata Motors Limited for the period of 2014-2019. The Financial leverage can be best described as the ability of a firm to use fixed financial leverages to magnify the effect of changes in EBIT on the firm's earnings per share. DFL and EPS increases or decreases with the corresponding increase or decrease in DFL with the fulfilment of main 2 criteria's: one being debt capital cheaper than equity capital and other being rate of the return on investment exceeding(after-tax) cost of debt. Greater operating leverage and financial leverage that may lead to the greater variability in earnings and also ultimately get greater systematic risk for the firm.

- The study has given the knowledge about the application of financial tools its importance and its usefulness in determining the capital structure of the Tata Motors.

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