

Relationship Between Financial Leverage And

A New Perspective on the International Evidence Concerning the Book-Price Effect - James Foye 2016

Finance theory implies equity returns should be positively related to financial leverage. However, Penman et al. (2007) decompose the book-price ratio into financing and operating components and report a negative association between financial leverage and returns. We shed new light on this puzzle by examining a region in which previous research has established that firms' financial leverage choices are motivated by factors other than maximizing shareholders' wealth: we hypothesize that this must be reflected in both how financial leverage is priced and the book-price ratio. We show that the relationship between equity returns and financial leverage for stocks in our sample is indeed very different to the findings of Penman et al. (2007), and this is reflected in the decomposed elements of the book-price ratio.

The Relationship Between Capital Structure Determinants and Financial Leverage for a Sample of Irish Listed Companies - Kevin Byrne 2016

Effect of Financial Leverage on Performance of Listed Firms in Nigeria - Okolie Ugochukwu Jude 2022-12-07

Academic Paper from the year 2021 in the subject Business economics - Banking, Stock Exchanges, Insurance, Accounting, grade: 4.5, Ahmadu Bello University, language: English, abstract: This paper analyzes the effect of financial leverage on firms' performance. The aim was to study the implications of financial leverage on firms performances. Also considering that maximizing accounting profit and maximizing shareholders value are not identical because of shareholders losses from agency costs, it was therefore pertinent to see how capital structure affect shareholders value. The objective of the study was to identify the possible effects of financing leverage on the performance of the company, to establish the relationship between leverage and corporate performance of listed firms in Nigeria, to determine the extent to which capital structure affect shareholders returns, to determine when the shareholder's wealth can be said to have been maximized given a particular capital structure and to analyze the debt and equity which might result in over capitalization of the firm. The research was designed to collect data through a survey method from five listed firms - Dangote Sugar Refinery, Nestle, Flour Mills, Cadbury, and Nigerian Breweries. Descriptive design (percentages) was used to explain the effect of financial leverage on company's performance; while analytical design (correlational statistical method) was used to establish the relationship between financial leverage and corporate performance.

An Empirical Study of the Relationships Between Financial Leverage and Capital Costs for Electrical Utilities - Louis Charles Gapenski 1987

A major element in utility regulation is the setting of just and reasonable allowed rates of return. This rate is a weighted average of the costs of the types of capital employed by the firm, and the weights should reflect the firm's target capital structure. The information required to set the target, or optimal, capital structure includes the relationships between the component costs of capital and the amount of financial leverage used. The primary objective of this study is to empirically estimate the relationships between financial leverage and the costs of common equity and debt for electric utilities. Two different approaches were used to estimate these relationships. First, an econometric model was developed with the component cost as the dependent variable and leverage as the independent variable. Other factors were included as independent variables to account for nonconstant business risk. Second, a model was developed using the bond rating guidelines and bond yields reported by Standard & Poor's Corporation. The data set consisted of about 70 electric utilities for 1983 and 1984. The results indicated a strong positive relationship between financial leverage and the costs of debt and equity. Several leverage measures were used, and the relationship was strongest when leverage was measured by market value debt-to-equity ratios. The relationships were stronger than reported in previous studies, and there was no indication that the relationships were nonlinear when leverage was measured by debt-to-equity ratios. Further, the two most important business risk factors to both debt and equity investors were nuclear construction programs and reserve margins. Somewhat surprisingly, regulatory climate did not affect debt or equity costs.

Encyclopedia of Finance - Cheng-Few Lee 2006-07-27

This is a major new reference work covering all aspects of finance. Coverage includes finance (financial management, security analysis, portfolio management, financial markets and instruments, insurance, real estate, options and futures, international finance) and statistical applications in finance (applications in portfolio analysis, option pricing models and financial research). The project is designed to attract both an academic and professional market. It also has an international approach to ensure its maximum appeal. The Editors' wish is that the readers will find the encyclopedia to be an invaluable resource.

The Trade-Off Theory Revisited - Kristoffer J. Glover 2013

This paper investigates the effect of operating leverage, and the subsequent abandonment option available to managers, on the relationship between corporate earnings and optimal financial leverage, thereby providing an alternative (rational) explanation for the observed negative relationship between these two quantities. Working in a dynamic capital structure setting, where corporate earnings are modelled as an exogenous stochastic process, we explicitly add fixed operating costs to the firm's value optimisation. This introduces a degree of operating leverage and a non-zero value to the implicit abandonment option of the firm's manager. Solving for the firm's optimal timing and financing decisions we are able to derive the relationship between current corporate earnings and optimal financial leverage for a large class of earnings uncertainty assumptions. The theoretical implications are then tested empirically using a large selection of S&P 500 firms. Our analysis reveals that the manager's flexibility to abandon the project introduces nonlinearities into the valuation that are sufficient to reconcile the trade-off theory with the empirically observed negative earnings/financial leverage relationship. We further find theoretical and empirical evidence of a positive relationship between operating and financial leverage. Previous studies have used mean-reverting earnings as an explanation for the observed negative earnings/financial leverage relationship in a trade-off theory setting. We show that the relationship does not need to be process specific. Instead, it is a direct result of the financial flexibility of managers.

What is the Relationship between Financial Leverage and the Expected Cash Flow? - Chun Chang 2009

Despite the theoretical attractiveness of the tradeoff theories of corporate capital structure, many of their main predictions still lack empirical support. For example, the existing empirical studies have consistently found a negative relationship between financial leverage ratios and cash flow (or profitability) ratios. This negative relationship is viewed as strong evidence against the tradeoff theories (Myers 1990). Rather than using the "stock" approach of the previous studies, this paper uses a "flow" approach designed to capture more precisely the implication of the tradeoff theories. We find that, for most firms, the amount of debt due in a period and the level of cash flow expected in that period are positively related. This evidence is consistent with several major tradeoff theories. It also provides support for the conventional wisdom that debt payments and cash flows should be matched.

An Empirical Examination of the Relationship Between Degree of Financial Leverage and Equity Returns of Lodging Firms - Anthony J. Gilardi 2003

Relationship Between Leverage and Profitability - Joel Minnema 2023-08-17

The relationship between leverage and profitability is a critical aspect of financial management for businesses. Leverage refers to the use of borrowed funds or debt to finance a company's operations and investments. Profitability, on the other hand, measures the company's ability to generate earnings relative to its expenses and costs. Leverage can impact profitability in two ways: positively through the magnification of returns and negatively due to increased financial risk. Positive leverage occurs when the return on the company's investments or assets exceeds the cost of borrowing. In this scenario, leveraging can amplify profits, enhancing overall profitability. However, excessive leverage can lead to negative consequences. High interest payments on debt can erode profits, especially during economic downturns, when cash flows

might be strained. Furthermore, heavy reliance on debt can increase the financial risk for a company. If the business fails to generate sufficient earnings to cover interest payments, it could lead to financial distress or bankruptcy, negatively affecting profitability. Striking the right balance between leverage and profitability is crucial. Companies must carefully evaluate their capital structure and risk tolerance to determine an optimal level of leverage that supports sustainable profitability. This requires a keen understanding of both the potential benefits and the risks associated with leveraging.

Impact of Financial Leverage on Financial Performance Special Reference to John Keells Holdings PLC Sri Lanka - Rajkumar Perinpanathan 2016

A general concept prevails that the financial leverage is helpful to enhance the financial performance of the companies. For measuring the impact of financial leverage on the financial health of the companies, it is essential to know whether a positive relationship exists between financial leverage and financial performance or not? So, this study is intended to test the hypothesis and to measure a relationship between the financial leverage and the financial performance of the John Keells Holdings PLC in Sri Lanka during the periods of 2006-2012. The findings of the study show a negative relationship between the financial leverage and the financial performance of the John Keells Holdings PLC. But the financial leverage has a significant impact on the financial performance of the John Keells Holdings PLC in Sri Lanka.

Impact of Financial Leverage on Firms' Profitability - Nawaz Ahmad 2016

This research is an attempt to establish a stochastic relationship between Financial leverage and Profitability of cement sector operating in Pakistan. For this purpose 18 cement manufacturers out of 21 are incorporated in the study and six years annual data from 2005 to 2010 regarding financial leverage and profitability of the said firms were taken into consideration. The sample size for eighteen firms for six years consists of 108 observations. An Ordinary Least Square model is applied on the data to establish a causal relationship between the variables. The study finds that financial leverage has a statistically significant inverse impact on profitability at 99% confidence interval.

The Relationship Between Average Cost of Capital and Financial Leverage - Stephan R. Flanagan 1964

Relationship Between Degree of Financial Leverage and Earning Per Share - Pradeep Kumar 2017

Degree of financial leverage refers to the effect of the use of debt capital on the earning per share of a company. This paper studied the relationship between degree of financial leverage and earnings per share of two leading Indian steel companies- Steel Authority of India Limited, and Tata Steel Limited for a period since 2006-07 to 2014-15. This study used the secondary source of data i.e. Annual Reports of SAIL and Tata Steel Limited. We found a negative correlation between degree of financial leverage and earnings per share in SAIL, whereas no relationship was found between degree of financial leverage and earnings per share in Tata Steel Limited.

The Relationship Between Financial Leverage and the Average Cost of Capital to Firms in the Iron and Steel Industry - Paul M. Cryder 1961

The Leverage Effect on Financial Performance. A Review of Empirical Evidence - John Joseph 2018-06-22

Seminar paper from the year 2018 in the subject Business economics - Business Management, Corporate Governance, , language: English, abstract: The International Financial Reporting Standards (IFRS) is a high quality and principle based reporting standards that remove many accounting alternatives. It is therefore, consequently expected to limit the management's discretion and lessen practices on earnings management. Quite the opposite, some researchers argue that the flexibility in IFRS and its fair value pre-eminence might afford greater opportunities for firms to manage earnings. It is this inaptness which incited and aggravated the conduct of this study. This study applies a desktop review to investigate the worldwide existing empirical research evidence on the effect of IFRS on earnings management post- IFRS adoption and in relation to other reporting standards and reports whether the results are indistinguishable between developed and developing economies. Accounting research in developed economies has long identified earnings management as a means by which managers manipulate financial reports to mislead other stakeholders on the underlying economic performance of the firm. However, earnings

management research did not receive much attention in developing countries such as Nigeria until recently. The findings reveal that the existing empirical crams and conclusions there on are mixed, inconsistent and difficult to generalise. This indicates the pressing need for country, especially Nigeria to engage on studies of this nature. The study further, stumbles on the fact that IFRS can indistinctly benefit both developing and developed markets when coupled with appropriate effective enforcement machinery. Substantially, the results entail that IFRS is a critical determinant for quality reporting but not a 'prima facie' guarantor for quality reporting.

The Effect of Financial Leverage and Market Size on Stock Returns on the Karachi Stock Exchange - Sadaf Mustafa 2017

This paper studies the effect of financial leverage and market size of selected stocks on stock returns. Ordinary Least Square (OLS) regression models were used to test the relationship between the dependent and independent variables. The leverage of the selected sector was estimated from the Annual Financial reports covering a period of twelve years from 2004 to 2015 non-financial sectors listed in Karachi Stock Exchange. Furthermore, stock index prices of the selected stocks between 2004-2015 for non-financial sector are used to calculate stock return. Capital structure decisions are very important for any firm because they have a direct impact on firm value as well as shareholder's wealth. The positives or negatives of these decisions determine the future value of any business. Some studies discussed multiple outcomes or relation between stock return and leverage. Some studies reveal positive relationship between them, some review show negative outcomes and some has blended results. The study concluded that there is statistically significant direct relationship between size which is proxy of market capitalization and stock return (100 index prices). However, there is feeble and inverse relationship between financial leverage and stock return, and this relationship is not significant, so there is no statistically significant relationship between financial leverage and shareholders return.

Corporate Blockholders and Financial Leverage - Thuy Bui 2018

This research investigates the relationship between corporate block ownership and firm financial leverage. Corporate blockholders, which are nonfinancial firms who hold more than five percent equity in a target industrial firm, can affect the target firm's policies through their business relationships, monitoring, or expropriations. I find that corporate block ownership is negatively related to the target firm's financial leverage. In addition, corporate blockholders often obtain board seats of the target firm, indicating an active involvement of corporate blockholders in governance activities. Further analysis indicates that the negative relationship between corporate blocks and leverage becomes stronger when corporate blockholders have greater board representation on the target firm, when the firm has higher agency costs, and when there is no product market relationship between corporate blockholders and the target firm. Overall, my findings suggest that corporate blockholders play an important monitoring role and can substitute for other monitoring mechanisms including leverage and institutional investors.

Impact of Financial Leverage on Financial Performance - Rajkumar Perinpanathan 2016

A general concept prevails that the financial leverage is helpful to enhance the financial performance of the companies. For measuring the impact of financial leverage on the financial health of the companies, it is essential to know whether a positive relationship exists between financial leverage and financial performance or not? So, this study is intended to test the hypothesis and to measure a relationship between the financial leverage and the financial performance of the John Keells Holdings plc in Sri Lanka during the periods of 2006-2012. The findings of the study show a negative relationship between the financial leverage and the financial performance of the John Keells Holdings plc. But the financial leverage has a significant impact on the financial performance of the John Keells Holdings plc in Sri Lanka.

The Impact of Financial Leverage on Firm Performance - Evgeny Ilyukhin 2019

The relationship between financial leverage and firm performance is studied in this paper. Financial leverage can positively influence firm performance because leverage can be treated as a tool for disciplining management. As such a positive relationship between financial leverage and firm performance is expected based on the agency cost theory. However it is not always applicable to the firms with too high portion of debt. It is because high indebtedness may lead to significant financial limitations and that influences firm performance negatively. A ratio of

firm debt to total assets is used as financial leverage measure while return on assets, return on equity and operating margin are employed as firm performance measures. The results for a large sample of Russian joint-stock companies over the period 2004-2013 years show that the impact of financial leverage on Russian firms' performance has been negative. It can be explained by ineffective corporate control of Russian market, debt attracting difficulties, high growth potential and high interest rates for financing through debt. The findings are robust to using different measures of firm performance, checking sub-samples and time clusters and employing alternative estimation approach. The results thus support pecking-order theory but are not consistent with trade-off or free-cash-flow theories.

The Determinant of Capital Structure. Evidence from Pakistani

Cement Industry - Farhan Iqbal 2016-03-10

Wissenschaftlicher Aufsatz aus dem Jahr 2015 im Fachbereich BWL - Investition und Finanzierung, , Sprache: Deutsch, Abstract: This paper is an attempt to determine the capital structure of listed firms of the cement industry in the Pakistan stock exchange (KSE). The main objectives of this empirical study is to forecast the relationship of dependent variable (financial leverage) with independent variables (size, tangibility, profitability, liquidity, tax rate and growth rate). The study showed a positive and significant association of firm size, tangibility and tax rate with financial leverage of the firm but in contrast to this, profitability, liquidity and growth rate showed a negative relationship with financial leverage.

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