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A Study on the Impact of Financial Leverage on Profitability: Evidence from Rajendra Coffee Ltd, Kodagu

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Abstract:
Leverage Analysis is one of the best tool that an organization can use for its self-analysis of growth or decline. Through Leverage analysis firm can analyse the effects of fixed cost expenses and the returns or the income. This research paper focuses on measuring the influence of Leverage analysis over the growth of the firm. Data is retrieved from the previous three-year financial statement of the firm. And also under this study the current status of the operational leverage, financial leverage and combined leverage has been employed to predict the optimum use of financial resources of an organisation. The major objective of the study to give feasible solution to the selected company "The Rajendra Coffee Limited, Kodagu, Karnataka" Which is agro based industry to survive with numerous competitors. Due to stiff competition, there is a chance of unstable profit in the business. Expected profit will be highly influenced by major externalities. The study gives a rational solution to the company to be the best performer among major key players in the field, by applying strategical approach to earn reasonable return in financial performance.

Keywords: *Leverage, Financial efficiency, Expected Profit, Reasonable return..*

I. INTRODUCTION

Business competency measured with its financial performance in terms of profit. Generally, the capital structure of an organisation is the fundamental platform to determine the financial commitments of the firm. The selection process of Debt-equity is a strategic decision in finance in the financial streamline of the organisation, which will lever the profit. The financial viability can also have the strong influence on Assets management principles in estimating risk. Adding the debt in its structure is the crucial factor which will affect the ROI of Shareholders equity. Effective taxation policy, dividend policy, Self-financing principles always helps the stakeholder to yield good amount of return in near future. Fixed bearing securities will yield high risk to the firm. Major involvement of huge fund in day to day commitments will directly affect owners' equity and the image of organisation in front stakeholders. A sound Leverage policies and trade off will help us to reduce the cost of capital commitment to the company. Business analyst mainly focuses on the factors that have a direct impact on the firm's profit. Money leverage is the major issue among the opposite factors that may have an effect on the firm's profit. Selection of debt intensive or equity intensive company that formulate the finance of the corporate assets results in the idea of capital structure formulation. Financing their assets using debt and equity is extremely vital for any company. Associated cost of capital, quantity of economic leverage and its influence on the firm's profit are the major issues where each individual business need to provide a special focus. Usually, Money leverage magnitude relation states the extent to which fund has been borrowed to capitalize the firm's capital structure. If company capitalizes additional fund than it need to pay additional charge related to that commitment and vice-versa. Value of fixedcharge lead to fixed costs in relating to the borrowed cash, in terms of interest.Increase in borrowed fund from creditors enable the company to pay additional quantity of price of debt to creditors which is named as charge per unit, this results in lower profit for the firm. In economic boom, higher money leverage provides edges to the firm but which will be absolutely opposite in economic recession. Optimum

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capital structure and its formulation will be the crucial element in the fixed financial commitment of the firm in long run. The good trade off policies will have less impact on levered effect. The researcher has made an attempt to analyse the impact of financial leverage on profitability during the study period. Both profitable and financial leverage ratios will have possible influence. But dynamic profitable ratios are the opt parameters, which will have only impact from leverage ratios. With this context, the researcher tried to correlate the portability and leverage ratios in his study period.

II. PROFILE OF THE COMPANY

The Rajendra Coffees Limited's is a Public incorporated on 19th July 1944, It is identified as Non-Government Company and registered at Registrar of firms, Bangalore. Its authorized share capital is Rs.25,00,000 and its paid up capital is Rs. 8,00,000. It's involved in Growing of crops, agribusiness and market gardening. It's Annual General Meeting (AGM) was last held on27thSept 2019 and its balance sheet was last filed on 31stMarch 2019, as per the records from Ministry of company Affairs (MCA). Directors of Rajendra Coffees limited are, Shaji, Mariamma George, Manamel Mathew Chandy, ManamelCherianChandy, ManamelOommenAbraham and ManamelPothen Georgesaint. The Rajendra Coffees Limited's operating revenues range is "INR 1 crores - 100 crores" for the recent financial year ending on 31 March, it's "EBITDA" has decreased by -9.69 % over the previous year. At the same time, its net worth has increased by 4.70 %.

III. LITERATURE REVIEW

A pursuit paper by Mehdi Moradi, Mahdi Salehi and ZakihehErfanian, titled, "A Study of the results of financial Leverage on Earnings Response constant throughout gain Approach: Iranian Evidence", has analysed with the help of secondary data fromIranian capital exchange for the period of 2002 to 2008. are by using multiple regressions. It has been found that the earnings' response constant one based on the effective capital structure planning.
Sanjay J. Bhayani and Butalal Ajmer in a very analysis paper titled, "An Empirical Analysis of economic Leverage, Earnings, and Dividend: A Case Study of Maruti Suzuki Bharat Ltd.", have studied economic leverage, earnings per share and dividend per share of MarutiUdyog Ltd for the period of 2001-02 to 2008-09. Hypothesis has been tested by correlation-co-efficient and the result has beencorrelation between DFL and EPS but the value has been insignificant to DPS.

Priyanka Sharma, AnkitSaxena and KarishmaChaudhary, has analysed the paper titled, "Leverage Analysis of Amul–Anand Milk Union Limited", Ahmedabad, in Feb 2014, by comparative study to prove that there was a significant influence on operating leverage for the optimum capital structure in his research period.
Sheel (1994)has described that thereis a negative relation between debts to assets. Cross-sectional multivariate analysis is used to review the leverage behaviour of 32companies in manufacturing sector. It has been proven that that each one leverage- determinants leverage variations in debt behaviour except the firm's size.

Mandelker & Rhee (1984)haveconducted research in selected industries usually have very cheap leverage in positive abnormal returns related to leverage increasing during stock repurchase or debt for equity exchange rather than leverage decreasing events like issuance stocks. It has also stated that corporationsprefer to use internal funding like preserved earnings before reinstating to any external funding.

Wassels (1988)have observed in his research that companies earn additional profit by using their earnings ratherthan outside capital which results in less leverage for the company. Performance of the firm will be elucidatedby the value of its stock. If firm's stock worth is higher than the companies, then it focuses on equity rather than outside capital which keep up their leverage.

IV. STATEMENT OF THE PROBLEM

Rajendra Coffee Ltd, Coorg, involves huge amount of equity capital to the involvement of production and related curing process of Coffee. Since the product is continuous and consistent demand as a beverage in India and other Nation's, the productivity will happen throughout the year. Both Direct and indirect expenses are inevitable in nature to these type of manufacturing unit. Return on investment will be bring task to these organizations, at reasonable cost in expected life period. Numerous externalities will influence the profit measurement. Therefore, the researcher has tried an attempt to undergo his research on the topic "A Study on

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the Impact of Financial Leverage on Profitability: Evidence from Rajendra Coffee Ltd, Kodagu."

V. OBJECTIVE OF THE STUDY

To examine the impact of Financial Leverage on profitability performance of the selected Company.

VI. HYPOTHESIS

H1: Financial Leverage has positive influence on the Profitability.

VII. METHODOLOGY

We employed the Descriptive statistics to understand how the Financial Leverage variables affect the "Profitability of an Organization". By using the data of the selected firm between 2014 and 2018. All dynamic Financial Leverage ratio's substantiated to endorse the result in consonance with the Profitability of the firm. To infer the result Regression is applied to find the association between two variables namely "Leverage" and "Profitability".

VIII. FRAMEWORK OF THE ANALYSIS

Leverage always has a positive impact over the company's growth and its analysis helps in the long-term solvency of the company as well as its related assets. Financial Leverage analysis helps the firm to analyse its growth status and helps in improvement. It is one of the major method used by the companies to achieve its long-term solvency and goals. Leverage speaks about the company's current financial status and helps to assess the financial stability.

FINANCIAL LEVERAGE RATIOS
"Debt ratio": "Total liabilities/Total assets"
"Equity ratio": "Total equity/Total assets"
"Asset turnover ratio": "Net sales/average total assets"
"Debt-equity-ratio": "Short term debt +Long term debt+other fixed payments/average total assets"
"Asset coverage ratio": "(Total asset-intangible asset)- (current liabilities-short term debt)/total debt"

PROFITABILITY RATIOS
'Operating Profit Margin Ratio': "Gross Profit/Revenue"
'Operating Margin-Om': "Operating Income/Net Sales"
'Return On Equity-Roe': "Net Income/Shareholder's Equity"
'Return On Assets-Roa': "Net Income/Average Total Assets"
'Return On Sales-Ros': "Operating Profit/Net Sales"

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TABLE 1: SUMMARY OF MEAN MEDIAN AND STANDARD DEVIATION

RATIOS	MEAN	MEDIAN	STANDARD DEVIATION
"Equity ratio"	2.9518	0.3367	5.8229
'Assets coverage ratio'	2.9471	0.3725	5.7898
'Asset turnover ratio'	4.5094	0.4416	9.2585
'Debt ratio'	3.4935	0.2948	7.0629
'Debt equity ratio'	2.3363	0.3230	4.4558
'Gross profit margin'	0.1147	0.1081	0.0445
'Operating margin'	1.1135	0.1081	0.0422
'Return on asset'	0.3537	0.3367	0.0565
'Return on equity'	0.3770	0.3563	0.0572
'Return on sales'	0.0805	0.0750	0.0370

Source: Computed

Interpretation:

From the above table, it has been found that profitability ratios have been high mean ratio in Assets turnover ratio (4.5094) and the least value in return on sales (0.0805) which also reflected in the Gross operating ratio as 0.1147. It has been identified that there has been less in all profitable ratios which could be inferred that there is a less influence on leverage variables in profitability.

TABLE 2: SUMMARY OF THE REGRESSION ANALYSIS

PROFITABILITY RATIO	R VALUE	R SQUARE
"Gross profit margin"	0.174	0.030
"Operating margin"	0.200	0.040
"Return on asset"	0.201	0.041
"Return on Equity"	0.348	0.121
"Return on Sales"	0.325	0.105

Source:Computed

Interpretation:

The coefficient value of 0.174 indicates a low degree of dependent variable of Gross profit margin on leverage ratio and the coefficient value of 0.348 indicates that high degree of dependent variable of return on equity on leverage ratio

The coefficient of determination (R Square) signifies that 0.030 of variation and 34.8% changes in dependent constant has been described by the independent variable.

IX. CONCLUSION

This paper has examined to highlight the effect of Leverage. It involves the Comparison of Financing under various alternative financing proposals. A firm may raise funds in the combinations of debt and equity instead of exclusive use of Debt.As it deals with Debt Equity composition of the organisation, the resultant risk and return for shareholders is an utmost concern for positive financial impact. In a situation where the proportion of equity fund is less than the proportion of the debt, the return as well as the risk of the shareholders will be low. This balanced Capital Structure will signify the neutral risk and return level.The effect of Capital structure where risk and return to shareholders may reasonably help the firm to decide their short term and long term strategies. A wise trade off in the capital structure will help to improve the efficiency of an organization.

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