International Journal of Sciences and Innovation Engineering
(Peer-Reviewed, Open Access, Fully Refereed International Journal)
website: www.ijsci.com
Vol.02 No.05. P. 88-98
OPEN ACCESS
E-ISSN : 3049-0251
DOI: https://doi.org/10.70849/ijsci

FINANCIAL LEVERAGE ANALYSIS WITH SPECIAL REFERENCE TO WEG INDUSTRIED, HOSUR.

Dr. Suresh Kumar M A[*1]
[*1] Associate Professor, Adhiyamaan College of Engineering (Autonomous), Hosur, Tamil Nadu, India
Bharath.Kumar C[*2]
[*2] II Year MBA, Department of Management Studies Adhiyamaan College of Engineering (Autonomous), Hosur, Tamil Nadu, India

Article Info

Article History:
(Article)

Published:14 MAY 2025

Publication Issue:
Volume 2, Issue 5
May-2025

Page Number:
88-98

Corresponding Author:
Dr. Suresh Kumar M A

Abstract:

Financial leverage is a measure of how much a company uses equity and debt to acquire their assets. The financial leverage ratio indicates the extent to which a company has used borrowed money to fund its capital structure. Profitability is a measure of an organization's profit relative to its expenses. The present study has been undertaken to examine and understand how Leverage plays a crucial role in the profitability of the company. It is concerned with examining the profitability position of the company, for a period of five years (2020-2024). The study covers the comparison between previous year's data with current year data. Data for the study has been collected over a period of five years, from respective company' annual reports from their official websites.

Keywords: Leverage, Profitability, Liquidity, Company, Equity, Debt

1. Introduction

Leverage is used to describe the firm's ability to use fixed cost assets or funds to magnify the return to its owners. James van Home has defined leverage, as "the employment of an asset or funds for which the firm pays a fixed cost or fixed return." In other words, Leverage is the employment of fixed assets or funds for which a firm has to meet fixed costs or fixed rate of interest obligation irrespective of the level of activities or the level of operating profit. The leverage can be favorable or unfavorable as the fixed cost or return has to be paid irrespective of the volume of sales, the amount of such cost or return has a significant effect on the profits available for equity shareholders.

Research Background

The use of the fixed-charges sources of funds, such as debt and preference capital along with the owners' equity in the capital structure, is described as financial leverage or gearing or trading on equity. The financial leverage employed by a company is intended to earn more return on the fixed-charge funds than their costs. The surplus (or deficit) will increase (or decrease) the return on the owners' equity. The rate of return on the owners' equity is levered above or below the rate of return on total assets

Identified Problem

Financial information collected for the present study is entirely secondary in nature. In such a case, the study carries all the limitations inherent with the Financial Strength indicates the financial position of the company.

A company is deemed to be financially sound if it is in a position to carry on its business smoothly and meet all its obligations both long-term as well as short-term without strain. The evaluation of financial strength of an enterprise is useful for all the parties interested in the enterprise directly or indirectly such as share-holders, creditors, investors, deposit-holders, financial institutions, Government, economists, trade unions, employees, public and researchers etc. Long-term financial strength depends on the structure that has been imposed on the business in financing more permanent asset requirements.

Objectives Of The Study

- To examine the long-term financial strength of the selected company
- The object of computing to measure the ability increase of the profitability ratio
- To understand the capital structure of the companies.
- Evaluate and analysis the financial leverage and capital structure
- To understand and analyse the leverage positions of the industries

Limitations Of The Study

Financial information collected for the present study is entirely secondary data and financial information.The study is restricted to the companies for the period of 5 years. While computing the data for the purpose of

analysis, the approximation of decimal places leads to minor variations in ratios as well as percentage analysis and hence these are bound to exist in the present study. Further, the annualized data are unlikely to reveal the true financial performance of the sample companies. The hidden inconsistencies of the financial statements are not probed into. While extending the results of the study, one should be careful to use the same judiciously by taking the limitations into consideration.

Scope Of The Study

Financial analysis is the procedure of ascertaining the operating and financial characteristics of a firm from accounting and financial statements point of view. The aim of the analysis is to determine the effectiveness or performance of a firm's management as reflected in the financial records and reports. The analyst endeavours to determine the Industry long-term solvency position and by taking the limitations into consideration.

Deliverabes

Leverage analysis deliverables typically include a summary of the analysis, key findings related to operating, financial, and combined leverage, and recommendations based on the analysis. This might also include calculated leverage ratios, charts visualizing leverage dynamics, and a comparison of the company's leverage with industry benchmarks

2. Review Of Literature

Anand M. Goel (2019) This paper develops a theory in which housing prices, the capital structures of banks (mortgage lenders) and the capital structures of mortgage borrowers are all endogenously determined in equilibrium. There are four main results. First, leverage is a "positively correlated" phenomenon in that high leverage among borrowers is positively correlated with high leverage among banks, and higher house prices lead to higher leverage for both. The intuition is that first-time homebuyers with fixed wealth endowments must borrow more to buy more expensive homes, whereas higher current house prices rationally imply higher expected future house prices and therefore higher collateral values on bank loans, inducing banks to be more highly levered. Second, higher bank leverage leads to greater house price volatility in response to shocks to fundamental house values. Third, a bank's exposure to credit risk depends not only on its own leverage but also on the leverage decisions of other banks. Fourth, positive fundamental shocks to house prices dilute financial intermediation by reducing banks' pre-lending screening, and this reduction

George Alexandridis ed all (2020) High capital intensity and reliance on debt financing are among the most prominent characteristics of the industry. The corporate finance literature has documented that beyond a certain threshold, leverage can hamper a firm's ability to raise capital, and as a result, have a bearing on its corporate investment policy. The new, more restrictive, financing landscape in the sector has put the management of capital structure on the spotlight as a key driver of investment policy, financial health, and thus, firm success. In this paper, we examine for the first time the link between the financing policy of companies and their corporate investment decisions. Higher debt levels are shown to have a negative effect on acquisitiveness and a positive effect on the quality of corporate investment; a pattern with direct policy implications for companies, their management teams, and shareholders.

Chunbo Liu (2023) Using the data of margin loans by Chinese stock investors, we find that investors take significantly fewer margin loans on a stock when the company announces new bank loans. This effect is entirely driven by investors' margin loan repayment upon announcements, and is stronger for firms with higher institutional ownership or lower leverage. The findings suggest that investors undo the change in firm leverage by adjusting margin loans usage, supporting the "homemade leverage" conjecture.

Flávio Morais ed all (2022) This paper investigates whether leveraged and zero-leverage firms pursue or not a debt target level and, if so, how fast they adjust to that target. We also investigate how the influence of firms' debt policy on capital structure speed of adjustment (SOA) changes with different financial systems, macroeconomic conditions, financial constraints and financial flexibility levels. We also find that, in general, leveraged firms display a significantly higher SOA than zero-leverage firms (27.6 % vs. 22.1 %), with only two exceptions: there are no significant differences when the analysis is restricted to financially constrained firms; and during the 2008 financial crisis zero-leverage firms adjusted significantly faster (46.8 %) than leveraged firms (25.6 %) and relative to non-crisis years (21.6 %).

Jingyi Gao (2022) This paper investigates the effect of participation in the global value chain on leverage dynamics by using novel matched Chinese firm data and the moderating role of foreign ownership. This paper shows firms with higher upstream may reduce leverage degree, and foreign firms' leverage reduces more. In addition, the effects show heterogeneity among areas and industries. We test the mechanism by adopting foreign ownership entry shock and the value-added ratio. The policy implication is straightforward the climbing of the global value chain and foreign ownership attraction can maintain the leverage risk for developing countries.

Jorgen A.B. Erichsen ed all (2020) Rooted in the industry, this article discusses the topic of leveraging tacit knowledge through prototyping. After first providing an overview on learning and knowledge, the Socialization, Externalization, Combination and Internalization (SECI) model is discussed in detail, with a clear distinction between tacit and explicit knowledge. Based on this model, we propose a framework for using said reflective and affirmative prototyping in an external vs. internal learning/knowledge capturing and transfer setting. Contextual examples from select automotive manufacturing R&D projects are given to demonstrate the importance and potential in applying more effective strategies for knowledge transformation in engineering design.

Katherine Ellsworth (2020) This paper presents a streamlined LCA for shaving, waxing and laser and connects this to a socio-material analysis of the history of hair removal in the USA to offer intervention into leverage points beyond Emma's choice of product. Our argument is not that avoiding shaving or waxing or laser is 'the best' action an individual could take to lower their environmental impact, instead we highlight how even the smallest activities coalesce into billion-dollar industries globally, with attendant billion tonne emissions. Thus, we utilise some of Danielle Meadows' twelve strategic leverage points to change systems in order to identify other interventions, such as (6) shifting information flows to make LCAs more impactful and accessible; (4) self-organising to normalise hairiness; or (3) changing the goals of the system.

Khushbakht Tayyaba (2018) has studied the effect of leverage on the profitability of the oil and gas sector. The study shows the relationship between leverage (Financial, operating and combined) and Earning per Share (EPS) of this sector. It analyses how earning capacity of this sector is affected by operating costs and fixed financial charges. It also shows the relationship between the Debt equity ratio and Earning per Share (EPS) and how this sector does debt financing efficiently. In this paper, oil and gas companies are selected for analysis and hypotheses are examined with the balanced panel using descriptive statistics, correlation and estimate equation

Kannan P, S. Salai Jeeva Gayatri (2019) The attempt was made to analyze and compare the liquidity ratios in industries in India in this study. The objective of the study is to evaluate the liquidity position of the selected companies. The researcher selected Company as a sample. Secondary data was used which was collected from the annual reports of the selected companies. The study was done for the period of five years. To measure the liquidity position of the company, liquidity ratios were to be used and also used Comprehensive test. The result of the study was that these two companies don't have good liquidity position.

Krishna Moorthi M, (2023) studied leverage analysis of selected companies in India. Four companies that satisfied the criteria are selected for the study. Secondary data was used for the study and analysed the data by using of mean, standard deviation, and one way ANOVA finally it conclude that companies belong to the same industry followed a different debt equity position during the study period.

Kalpana V (2021) analyses the impact of leverage on profitability of the select firms and the relationship among financial leverage, operating leverage and Composite leverage with earning per share of the firms. In addition to this it investigates how the profitability is influenced by fixed financial charges and fixed operating cost. In this study, select companies which are traded in BSE are taken for analysis and the study is based on the secondary data. Hypotheses are examined with the help of correlation and test of significance and also analysis of variance (ANOVA). From this study it is found out that there is a negative correlation between DOL and EPS, DFL and EPS, and DCL and EPS. The result shows that the use of debt and fixed cost expenses would reduce the profitability of the firms. It implies that in order to increase the earnings the firms need to reduce the use of debt in capital structure and fixed cost in operation of the firm.

Leven J. Zheng ed all (2023) The use of technology-driven applications has become widespread in the development and distribution of products and services. In our study, we aim to investigate the role of digitalization in establishing business sustainability within the industry, using a sample of Chinese listed firms. Specifically, we examine how digitalization impacts corporate social responsibility (CSR) performance. Our findings indicate that both internal and external digitalization have a positive association with CSR performance. This study is the first to explore the impact of both types of digitalization on CSR performance, and we also identify ownership structure as a positive moderator of this relationship. Our study contributes to the literature on digitalization, CSR, and stakeholders, providing practical insights for policymakers in the industry.

Lingdi Liu (2023) Facing the challenges of globalisation and unpredictable shocks, manufacturers seek novel methods to maintain the sustainability of their supply chains. Adopting Industry 4.0 (I4.0) technologies facilitates sustainable supply chain management (SSCM) with the precise decision-making of supply chain activities and the realisation of circular development. Remanufacturing, reusing, and recycling.

Mukti R. Barot (2021) The study tries to analyze the liquidity level of sector. The study select the five company and covers the period. For the analysis of selected data, ratio analysis was used as tools. The study is based on secondary data. The conclusion of the study was that the liquidity position is far better among all the selected companies. While the debt-equity ratio of the company is best compared to other selected companies. The study suggested that the rest companies should pay attention on the management of the companies to enhance their performance and improve their management skill.

Marouen Ben-Jebara ed all (2023) However, the implications of product personalization on shareholder wealth, with both positive and negative forces at play, remain unclear. This research evaluates how personalization focus by pharmaceutical firms affects their stock returns and idiosyncratic stock risk. It further examines the roles of marketing capability and financial leverage in these relationships. Results, based on a unique secondary data set, reveal that personalization focus has a nonlinear effect on shareholder wealth. Personalization focus is seen to increase (decrease) stock returns (idiosyncratic risk) but only up to a point, beyond which it decreases (increases) returns (risk). Marketing capability and financial leverage are observed to play complex roles in these relationships between personalization on stock returns and idiosyncratic risk but only when personalization focus is low or high. This study draws on these findings to illustrate research and managerial implications.

Paolo Saona (2022) One of the most puzzling, stylized facts in modern corporate finance is that many companies worldwide persistently follow a zero-debt or almost-zero-debt policy. This paper reviews the literature on this puzzling policy. We survey articles published in the Web of Science and the SCOPUS databases since the zero-debt policy was first formally discussed in 2022 when zero-levered companies started to emerge. Our literature review provides unique conceptual and methodological knowledge contributions, by critically analyzing prior works and paving the way for the advancement of new paradigms.

Rajni Saini (2019) in a research paper titled, "Impact Of Financial Leverage On Return And Market Capitalization: Empirical Evidence Of Sector Companies, India", has empirically explored the impact of financial leverage on shareholders return and market capitalization of sector companies in India. To measure this, financial statements of seven listed firms have been analyzed over a period of seven years. Descriptive Statistics, Co-relation and t-test has been conducted to find out nature of relationship and the state of influence of the financial leverage on shareholders" return and market capitalization individually. The research evidence of the study indicates that, there is positive correlation between financial leverage and shareholder return but negative correlation between financial leverage and market capitalization.

Rajni Luthra (2018) in a research paper, titled, "Impact of Leverage on the Capital Structure Practices of Selected Companies", have analysed the impact of leverage on the capital structure practices via profitability of selected companies in India. This paper investigates the relationship between leverage and earning per share and it also describes how the earning capacity of the firm is influenced by fixed operating costs and fixed financial charges. This study has also described the relationship between debt equity ratio and earning per share and how effectively the firm uses debt financing. He have also been used to check "Lack of Symmetry "to understand the distribution of data and flatness or peakedness. The results of the study suggested that leverage and profitability and growth are related and leverage is having an impact on the capital structure practices of the firm

Research Gap

A research gap in leverage analysis lies in the lack of comprehensive studies examining the impact of leverage on firm performance across different industry sectors, especially when considering the moderating effects of factors like economic conditions, corporate governance practices, and specific business strategies within those sectors, particularly in emerging markets where data might be limited.

3. Research Methodology

Research methodology is a systematic way of solving the problem. It includes the overall research design, the sampling procedure, data collection method and analysis procedure. A research design is the arrangement of condition for collection and analysis of data in a manner that may result in an economy in procedure. It stands for advance planning for collection of the relevant data and the techniques to be used in analysis, keeping in view the objectives of the research and availability of time, as the researcher is analysing the past data and predicts the future trend, it is naturally comes under analytical research design. The analysis of financial condition and performance of the enterprise necessitates with reliable data therefore the data for the present study is collected with the help of secondary data. The secondary data is mainly used for the study. It is taken from published sources of the company like the annual report magazines, documents and other financial official records.This study contains the FP analysis for the period of five years from 2020-2024. The following tools and techniques of financial analysis are used as a measure of judging the degree of, efficiency of financial performance analysis of the company

- Ratio analysis
- Trend analysis
- Compound annual growth rate

4. Data Analysis And Interpretation

The analysis of data requires a number of closely related operations such as establishment of categories, the application of these categories to raw data through coding, tabulation and then drawing inferences. The unwieldy data should necessarily condense into a manageable groups and tables for further analysis.Thus, researcher should classify the raw data into some purposeful and usable categories. Analysis work after tabulation is generally based on the computation of various percentages, coefficients, etc., by applying various well defined statistical formulae.The real value of research lies in its ability to arrive at certain generalizations. If the researcher had no hypothesis to start with, he might seek to explain his findings on the basis of some theory. It is known as interpretation. The process of interpretation may quite often trigger off new questions which in turn may lead further researches.

Financial leverage

The use of borrowed money to increase production volume, and thus sales and earnings. It is measured as the ratio of total debt to total assets. The greater the amount of debt, the greater the financial leverage. Since interest is a fixed cost (which can be written off against revenue) a loan allows an organization to generate more earnings without a corresponding increase in the equity capital requiring increased dividend payments (which cannot be written off against the earnings). However, while high leverage may be beneficial in boom periods, it may cause serious cash flow problems in recessionary periods because there might not be enough sales revenue to cover the interest payments. Called gearing in UK.

$$\frac{\text{EBIT}}{\text{EBIT} - \text{Interest}}$$

Operating Leverage

The percentage of fixed costs in a company's cost structure. Generally, the higher the operating leverage, the more a company's income is affected by fluctuation in sales volume. The higher income vs. sales ratio results from a smaller portion of variable costs, which means the company does not have to pay as much additional money for each unit produced or sold. The more significant the volume of sales, the more beneficial the investment in fixed costs becomes.

Combined Leverage

The Degree of Combined Leverage (DCL) is the leverage ratio that sums up the combined effect of the Degree of Operating Leverage (DOL) and the Degree of Financial Leverage (DFL) has on the Earning per share or EPS given a particular change in shares. This ratio helps in ascertaining the best possible financial and operational leverage that is to be used in any firm or business.

DCL = %Change in EPS / %Change in Sales = DOL * DFL

TABLE NO 4.4 EARNING PER SHARE (EPS).

Year	Net income	Average outstanding shares	EPS
2019-20	6631.16	57.45	115.42
2020-21	6544.20	57.50	113.81
2021-22	5919.91	57.54	102.88
2022-23	10175.63	57.66	176.48
2023-24	10024.25	57.79	173.46

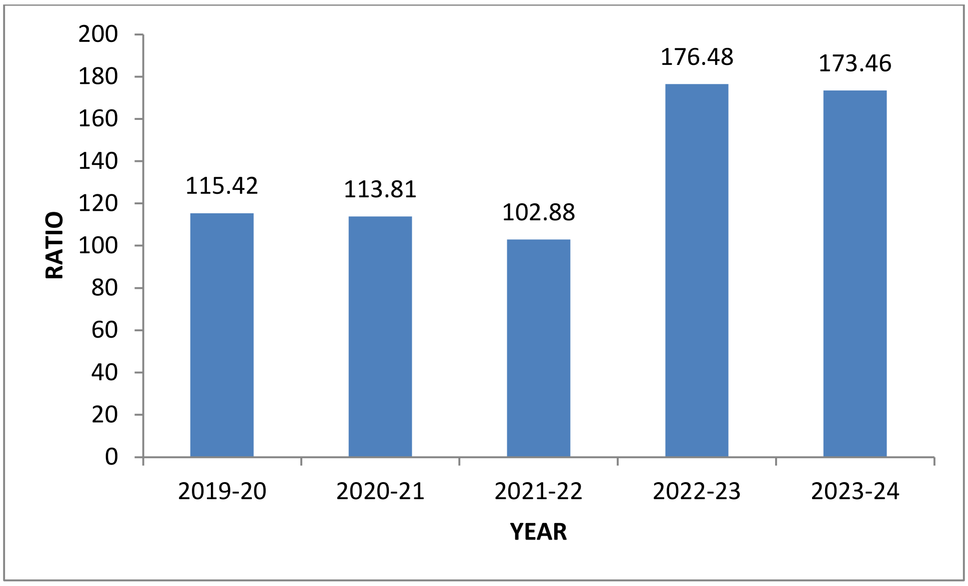

CHART NO 4.4 EARNING PER SHARE (EPS)

INTERPRETATION

From the above table shows the EPS ratio in the company. In the year of 2019-20 EPS ratio is 115.42 and it was decreased 2020-21 is 113.81. The net income level is High in the year of 2022-23 was 176.48. The last year of 2023-24 EPS was decreased to 173.46.

Suggestions

In the case of the industry, it is found that is high operating risk, in order to reduce the risk, it is suggested that the company employs greater amount of variables cost and smaller amount of fixed cost become low operating leverage will give cushion to the management by providing high margin of safety against fluctuations in sales. Since there is a negative correlation between the operating leverage and textile firm, it is suggested that the firm use low operating leverage in order to increase the EPS of the firms.In case of financial leverage, has highest FL. In order to reduce the risk, proper planning of capital structure is needed. It is suggested that they must increase the equity capital and reduce long term borrowing in the capital structure of the firm.

5. Conclusion

The study has been conducted to analyses the impact of leverage on profitability i.e. EPS of selected three steel companies. Leverage is an important factor which is having an impact on profitability of the firm which in turn affects the wealth of the shareholders. From this study it is found that there is a negative correlation between OL and EPS, FL and EPS, CL and EPS of textile firm. The result shows that the use of debt and fixed cost expenses would reduce the profitability of the firms. It implies that in order to increase the earnings the firms need to reduce the use of debt in the capital structure and fixed cost in operations of the firms. And there is a positive correlation between OL and EPS, FL and EPS, CL and EPS of VISA steel. It implies that the use of debt and fixed cost expenses increases the profitability of the firm

Findings

The financial leverage in the industry. In the year of 2019-20 financial leverage is 1.09 and the next year is small increase to 1.14 then next financial year of 2021-22 was 1.21. And it was decreased to 1.04 in 2022-23. The last year of 2023-24 is 1.07. The operating leverage for capital structure. In the year of 2019-20 is 0.21 less than 1 and the next year of 2020-21 ratio was 0.17. Then next year was increased to 0.28. The financial year 2023-24 were 0.15. It was continually fluctuated to year by year.The Combined leverage from 0.23 in the year 2019-20 It has been decreased to next year of 2020-21 was 0.19. Then next year of 2022-23 was increased to 0.29.The final year come down 0.16 in the year of 2023-24.The EPS ratio in the company. In the year of 2019-20 EPS ratio is 115.42 and it was decreased 2020-21 is 113.81. The net income level is High in the year of 2022-
23 was 176.48. The last year of 2023-24 EPS was decreased to 173.46The leverage position of the company interest covering ratio are very high 26.66 in the year 2022-23. It low level position for interest coverage ratio was 7.93 in 2020-21. The final year of interest coverage ration was 14.51 in The assets structure in the company. The company assets were 2019-20 was 0.43 and it was increased for next year. Company assets ratio of 2021-22 was 0.43. Then next year of 2022-23 decreased to 0.36. The next final year of 2023-24 was 0.39. The value of EPS is constantly decreasing from 2019-20 to 2023-2024. In the year 2019-20 was 12.11. The next year of 2020-21 earning per share decreased to 9.48. And then next years also decreased to 6.09. The final year of 2023-24 ratio was 12.95The value of Debt equity ratio from 2019-20 to 2023-2024. In the year 2019-20 was 33.75. The next year of 2020-21 increased to 34.58. And then next years also decreased to 32.08. The final year of 2023-24 is 29.00 it was decreased in the Debt equity ratio.The EBIT to total asset ratio is 0.19 in the year of 2019-20. Then the three years 2020-21,2021-22,2022-23 is fluctuate to 0.14, 0.13, 0.28. The final year of EBIT to total asset ratio was 0.15. So the EBIT to total asset ratio is moderate position.The Debt to EBIT in the company. The company Debt to EBIT were 1.44 in 2019-20 and it was increased for the next year of 2020-21. The next year of 2021-22 ratio was increased to 1.86. The company Debt to EBIT ratio was moderate level of 2023-24 and the next final year was 1.13. The Equity multiplayer ratio for the company. The Equity multiplayer ratio were 124.90 in 2019-20 and it was increased in the next year of 2020-21. The Equity multiplayer ratio was 164.78 in the year of 2022-23 and the next final year was 172.45. So the Equity multiplayer ratio was increasing in year by year.The debt equity

relationship of the company during the study period. It was 0.37 in the year 2019-20 and then decreased to 0.35 then next year decrease to 0.31 in 2021-22 again in the next year 2022-23 onwards it ultimately decrease to 0.26. It was decreased from the year 2023-24 is 0.20. Hence the company is efficient maintaining its debt position. The debt equity ratio was decreasing trend.The debt ratio for the company during the study period. It was 0.27 in the year 2019-20 and then decreased to 0.26 then next year decrease to 0.23 in 2021-22 again in the next year 2022-23 it decreased to 0.21. It was decreased from the year 2023-24 is 0.17.

Directions For Future Research

The concern hereby recommended that the company should try to increase its overall sale so that it can minimize the impact of increased operating & financial leverage. The profit should maintain along with the sale ,so that the risk associate can be identified The asset of the company should be increased A high and low operating and financial leverage both are very risky. The operating and financial position of the company was improperly fluctuated. A firm must maintain a proper balance between the financial and operating leverage. The company has to control fixed cost as well as variable cost to attain adequate profit. The company should increase profit through the reduction of its selling price & cost of production.

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