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RESEARCH ARTICLE

An empirical study of leverage and its impact on earning capacity in Indian engineering industry

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ABSTRACT : The engineering sector in India comprises basic industries such as Metal, Steel, Electrical Machinery, Non-Electrical Machinery and Transport Equipments. Manufacturers, Exporters and Suppliers of engineering machinery and equipment largely produce industrial machines, rolling mills machinery, plant machinery, plastic moulding machines, construction machines and equipment, railway products, die casting equipment and other special purpose machines. Majority of Indian engineering firms are pursuing a systematic approach to quality control and standardization so as to curve out market positioning in the competitive world market place. Engineering industry in India has been constantly updating its technology base and diversifying its manufacturing range in tune with global market requirements. Indian exporters are well aware and do not lag behind in adopting eco-friendly manufacturing techniques which have become the new emerging requirements of the global development. For the purpose of analysis, ratio techniques and to test hypothesis other statistical tools *i.e.* correlation has been used for the research purpose. The result of the study indicates that there is a correlation between DFL and EPS and the difference is insignificant where as result of correlation coefficient at 5 per cent level of significance showed that the diffidence is significant between DFL and DPS and EPS and DPS. For the purpose of analysis, ratio techniques and to test hypothesis other statistical tools *i.e.* correlation has been used for the research purpose. The result of the study indicates that there is a correlation between DFL and EPS and the difference is insignificant where as result of correlation coefficient at 5 per cent level of significance showed that the diffidence is significant between DFL and DPS and EPS and DPS.

KEY WORDS : Financial leverage, Operating leverage, Dividend per share, Earning per share, Capital structure, Dividend policy

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INTRODUCTION

Firms can raise money through a variety of means. Usually, money is raised through the issuance of different types of securities (such as stocks and bonds). The capital structure of a firm is the proportion of each type of security that the firm has used.

It is a double edged sword. Levered firms grow in boom period and in healthy financial position of a company with a great proportion as well as its graph of earning per share and dividend per share decreases with a high proportion, if company is running in losses. So both the aspects work. Impact of using debt money may be beneficial or risky, according to financial position. Its effect is in the same direction with high proportion. It is a good tool to use to run a business with high growth rate. Financial leverage works both ways. It accelerates EPS (and ROE) under favorable economic conditions, but depresses EPS (and ROE) when the going are not good for the firm. The favorable effect of the increasing financial leverage during normal and good years is on account of the fact that the rates of return on assets exceed the cost of debt.

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About the engineering industry :

The Engineering sector is the largest in the overall industrial sectors in India. It is a diverse industry with a number of segments, and can be broadly categorized into two segments, namely, heavy engineering and light engineering. The engineering industry in India manufactures a wide range of products, with heavy engineering goods accounting for