A study on leverage analysis of TVS motor company limited

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Abstract
The main objectives of this study are to analyze and understand the impact of leverage on profitability of the TVS Motor Company. Traditionally, discussions on leverage were viewed from the perspective of financial leverage which arises from financing activities. However, operating leverage arising from the operating activities of business is also used extensively these days. Operating leverage increases the returns to limited equity funds by using the money to “control” assets rather than “own” them. The present study makes an attempt to analyze the impact of both financial leverage as well as operating leverage on the profitability (measured through Earning Per Share “EPS”) of the TVS Motor Company. The company has to control fixed cost as well as variable cost to attain adequate profit.

Keywords: Finance, leverage, selling price, cost of production, debt, Borrowings.

Introduction
Finance is the life blood of every economic activity. It is the study of funds and management. Its general areas are business finance, personal finance, and public finance. It also deals with the concept of time, money, risk, and the interrelation between the given factors. It is basically focused on how the money is spent and budgeted. It is one of the most important aspects in handling business. Finance addresses the method wherein business entities used their financial resources on a certain period of time. It is the application of a set of techniques used by organizations in managing their financial affairs. The income and expenditure are emphasized in finance and its differences can easily be indicated. Leverage analysis is the methodical classification of the data given in the financial statement. It is the process of identifying the financial strength and weakness of a firm from the available accounting data and financial statements.

Statement of the Problem
The financial statement is a mirror, which reflects the financial position and operational strength and weakness of concern. But a mere look at the financial statement will not reveal some crucial information. To bring out the hidden information, financial statements over a period are to be studied. Hence the study is conducted to evaluate the relationship between component parts of the financial statements of the TVS MOTOR COMPANY LIMITED and to obtain better understanding of the company position and performance. Leverage analysis reveals the utilization of firm’s debt into very effective way.

Scope of the Study
Scope of the study covers the area of study. The study concerned with analyzes of leverage position of the company.

Objectives of the Study
➢ To know the overall operating efficiency and performance of the firm through financial analysis.
➢ To measure the growth of company.
➢ To offer suitable suggestions based on findings.
Methodology

Sources of Data
The study is based on secondary data. It was a case study, studying particular unit, i.e. TVS Motor Company Ltd. For the purpose of analysis, the researcher has collected final accounts of TVS Motor Company Ltd. The researcher has gone through various journals, magazines, newspapers, publications and websites for obtaining information.

Area and Period of Study
The study concerned with financial aspects of TVS Motor Company Ltd. The Study period consist of 5 years from 2008-2009 to 2012-2013.

Tools for Analysis
The researcher has analysed the financial statements of TVS Motor Company Ltd with the help of ratio analysis such as:
- Leverage Analysis

Limitation of the Study
- This study is concentration on one particular company, not inter firm comparison.
- The study is based on secondary data to that extend it has limitations.
- Lack of availability to certain data due to confidentiality of information.
- Due to constraints of time cost and non-availability of data, the study was restricted to a period of 5 years.

Review of Literature

Raheman and Nasr (2007) [1]. Studied the relationship between capital and earnings management for 94 companies listed on the stock exchange in Karachi, Pakistan. One of their findings was to obtain on a significantly negative relationship between liquidity and profitability of analyzed companies.

Garcia-Terul and Solano (2007) [2]. Have studied the effects of working capital management on the profits made from use of assets (ROA) for companies. They analyzed 8872 companies and found out that shortening the cash conversion cycle had no significant effect on the profitability of companies.

Frank Verbeelan and Pieter Vijin (2007) [3]. In their study an empirical study of the relationship between brand assets and financial performance studied whether the brand assets provide incremented value, is an indicator an accounting of performance. Their result indicates Brand Vitality is positively and significantly associated with financial performance.

Reference
- Raheman and Nasr, negative relationship between liquidity and profitability of analyzed companies, 2007.
- Garcia-Terul and Solano, significant effect on the profitability of companies, 2007.
- Frank Verbeelan and Pieter Vijin, in their study ‘an empirical study of relationship between brand asset and financial performance’ nyenrode research paper series, nyenrode Business University, 2007.

Company Profile
TVS Motor Company, the flagship company of the TVS Group, is India’s third largest two-wheeler manufacturer and one among the top ten in the world. The TVS Group was established back in 1911, when the founder of the company, Shri T V Sundaram Iyengar created an enduring business, led by a family of like-minded workers and managers united by a set of high, yet shared principles. Driven by this inspiration, the TVS group has today emerged as India's leading player in the automobile and automotive components industries. The group has 30 companies employing a workforce of around 40,000 people. TVS Motor Company is today the largest among the group companies in terms of size and turnover.

Today, TVS Motor Company has,
- 4 manufacturing plants (Hosur in Tamil Nadu, Mysore in Karnataka, Nalagarh in Himachal Pradesh – India and Karawang - Indonesia)
- 16% market share in the two-wheeler industry in India
- Product offerings in all segments of the two-wheeler industry in India
- Product offerings for the three-wheeler industry in India
- More than 15 million customers
- Products exported to more than 50 countries worldwide

Leverage Analysis

Leverage is a business term that refers to borrowing. It general term for any technique to multiply gains and losses. If a business is "leveraged," it means that the business has borrowed money. If the company has too much borrowing, it may not be able to pay back all of its debts. Common ways to attain leverage are borrowing money, buying fixed assets and using derivatives.

Types of Leverage

Leverage can be defined as “the employment of an assets or source of funds for which the firm has to pay a fixed cost or fixed return”. Because of the incurrence of fixed costs, the net income and the earnings available to the equity shareholders as well as the risk gets affected. Leverage is favorable when the earnings less the variable costs exceed the fixed costs when the earnings before interest and taxes exceed the fixed return requirement. Leverage is unfavorable in the reverse situation.

The various types of leverage are:
- **Operating Leverage:**
  The leverage associated with investment i.e., asset acquisition activities are called as operating leverage.
- **Financial Leverage:**
  The leverage associated with financial activities is called a financial leverage.
- **Combined Leverage:**
  This is the product of the operating and financial leverages.

Operating Leverage

The percentage of fixed costs in a company’s cost structure. Generally, the higher operating leverage, the more a company’s income is affected by fluctuation in sales volume. The higher income vs. sales ratio result from a smaller portion of variable costs, which means the company, does not have to pay as much additional for each unit produced or sold. The more significant the volume of sales, the more beneficial the investment in fixed costs.
Formula
Operating Leverage = Contribution/Ebit
Contribution = Sales – Variable Cost
Operating Profit / EBIT = Contribution – Fixed Cost

![Table 1: Operating Leverage (Rs in Crores)](image)

<table>
<thead>
<tr>
<th>S.NO</th>
<th>YEAR</th>
<th>CONTRIBUTION</th>
<th>EBIT</th>
<th>RATIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2008-2009</td>
<td>887.53</td>
<td>86.11</td>
<td>10.31</td>
</tr>
<tr>
<td>2</td>
<td>2009-2010</td>
<td>1225.76</td>
<td>139.34</td>
<td>8.80</td>
</tr>
<tr>
<td>3</td>
<td>2010-2011</td>
<td>1565.57</td>
<td>295.08</td>
<td>5.31</td>
</tr>
<tr>
<td>4</td>
<td>2011-2012</td>
<td>1993.92</td>
<td>373.55</td>
<td>5.34</td>
</tr>
<tr>
<td>5</td>
<td>2012-2013</td>
<td>2152.68</td>
<td>211.62</td>
<td>10.17</td>
</tr>
</tbody>
</table>

Source: Annual report

The above table 1 reveals that the contribution of the company was fluctuated positively during the study period. The EBIT of the company also increased till the year of 2011-2012 and in the year of 2012-2013 it was decreased. The operating leverage of the company was highest (10.31 times) in the year 2008-2009 and it was lowest (5.31 times) in the year 2010-2011.

Financial Leverage
Financial leverage is the using of equity share capital and preference share capital along with long term fixed interest bearing debt. The company can use long term fixed interest bearing debt very effectively. If so, the earnings of more than fixed interest is available only to the equity shareholders. In this way, the return to equity shareholders is increased. It means that the earnings of equity shareholders are increased by effective use of long term fixed interest bearing debt. It is also known as trading on equity.

Formula
Financial Leverage = EBIT/EBT

![Table 2: Financial Leverage (Rs in Crores)](image)

<table>
<thead>
<tr>
<th>S.NO</th>
<th>YEAR</th>
<th>EBIT</th>
<th>EBT</th>
<th>RATIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2008-2009</td>
<td>86.11</td>
<td>31.10</td>
<td>2.77</td>
</tr>
<tr>
<td>2</td>
<td>2009-2010</td>
<td>139.34</td>
<td>76.17</td>
<td>1.83</td>
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<tr>
<td>3</td>
<td>2010-2011</td>
<td>295.08</td>
<td>248.09</td>
<td>1.19</td>
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<tr>
<td>4</td>
<td>2011-2012</td>
<td>373.55</td>
<td>316.46</td>
<td>1.18</td>
</tr>
<tr>
<td>5</td>
<td>2012-2013</td>
<td>211.62</td>
<td>163.58</td>
<td>1.29</td>
</tr>
</tbody>
</table>

Source: Annual Report

Table 2 states that the EBIT & EBT of the company was inclined during the study period. The financial leverage of the company was highest (2.77 times) in the year of 2008-2009 and it was lowest (1.18 times) in the year 2011-2012.

Combined Leverage
Combined leverage is a leverage which refers to high profits due to fixed costs. It includes fixed operating expenses with fixed financial expenses. It indicates leverage benefits and risk which are in quantity. Competitive firms choose high level degree of combined leverage whereas conservative firm choose lower level of degree of combined leverage. Degree of combined leverage indicates benefits and risks involves in this particular leverage.

Formula
Combined Leverage = Operating Leverage × Financial Leverage

![Table 3: Combined Leverage (Rs in Crores)](image)

<table>
<thead>
<tr>
<th>S.NO</th>
<th>YEAR</th>
<th>OPERATING LEVERAGE</th>
<th>FINANCIAL LEVERAGE</th>
<th>RATIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2008-2009</td>
<td>10.31</td>
<td>2.77</td>
<td>28.54</td>
</tr>
<tr>
<td>2</td>
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<td>8.80</td>
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<tr>
<td>3</td>
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<td>6.31</td>
</tr>
<tr>
<td>4</td>
<td>2011-2012</td>
<td>5.34</td>
<td>1.18</td>
<td>6.30</td>
</tr>
<tr>
<td>5</td>
<td>2012-2013</td>
<td>10.17</td>
<td>1.29</td>
<td>13.16</td>
</tr>
</tbody>
</table>

Source: Annual Report

It can be understood from the table 3 that the operating and financial leverage of the company was improperly fluctuated during the study period. The composite / combined leverage of the company was highest (28.54 times) in the year 2008-2009 and it was lowest (6.30 times) in the year 2011-2012.

Findings
- The operating leverage of the company was highest (10.31 times) in the year 2008-2009 and it was lowest (5.31 times) in the year 2010-2011.
- The financial leverage of the company was highest (2.77 times) in the year 2008-2009 and it was lowest (1.18 times) in the year 2011-2012.
- The composite / combined leverage of the company was highest (28.54 times) in the year 2008-2009 and it was lowest (6.30 times) in the year 2011-2012.

Suggestions
- The leverage position of the TVS Motor Company Limited, during the study period is in satisfactory level and researcher was able to give opinion with regard to the company’s point of view. The following are the suggestions made on the basis of findings
  - 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 should increase profit through the reduction of its selling price & cost of production.

Conclusion
The study was undertaken to analyze the leverage position of the TVS Motor Company Limited. From the study, it can be concluded that the company’s overall financial and operating efficiency was satisfactory. The researcher has found that the company suffers from certain weakness and has given some suggestions to overcome it. If the suggestions are implemented, The company can increase profitability and overall performance.

Reference