

A STUDY ON LEVERAGE ANALYSIS OF TATAMOTORS LTD

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Abstract

This study examines the influence of leverage analysis on the performance of the company. It is measured using EBIT-EPS analysis. In this paper an attempt is made to analyze the leverage analysis of Tata Motors Limited during the period 2009-2010 to 2013-2014, so as to understand the factors that influenced the leverage analysis decisions of the company and to know the impact of leverage analysis decisions on profitability and performance of the company. The company's performance is measured through EBIT-EPS analysis. Increase in the level of debt and net worth increases the debt equity ratio. Leverage analysis is the crucial decision to be taken by every business, the positives and negatives of these decisions plays an important role in determining the future of every business.

Keywords:

Leverage; EPS; Level of debt; worth; Debt equity

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Introduction

Finance 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.

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 Tata motors Limited and to obtain a better understanding of the company position and performance. A financial analysis reveals the financial strength and weakness of the firm by properly establishing the relationship between the item of balance sheet and profit and loss account. The study is also conducted to find out the company efficient in the management of its assets.

Objectives of the Study

- To analyze the capital structure or leverage of the company.
- To offer finding and suitable suggestions for further improvement.

Methodology

Sources of data

The study is based on secondary data. It was a case study, studying particular unit, i.e. Tata motors Limited. For the purpose of analysis, the researcher has collected final accounts of Tata motors Limited.

The researcher has gone through various journals, magazines, news papers and publications for obtaining information.

Area and period of study

The study concerned with financial aspects of Tata motors Limited. The study period consists of 5 years from 2009-2010 to 2013-2014.

Tools of Analysis

The researcher has analysed the financial statements of Bajaj Auto Limited with the help of ratio analysis such as

- ❖ Leverage analysis

Limitation of the Study

- ❖ 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

Frank Verbeelan and **Pictor Vijin**ⁱ (2007) in their study "An empirical study of the Relation 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.

John Moes and **Eilip Rood Hoof**ⁱⁱ (2005) in their study modeling the link between management practices and Financial performance, evidence from small construction companies, studied the direct and indirect effects of owner- manager and company characteristics and selected management practices on the Financial performances. Their findings indicate that a model approach by including owner-manager and company characteristics and management practices in an intervened way is necessary when exploring the effects on small business financial performances.

Profile of The Company

The company was incorporated on 1st September 1945 at Mumbai to manufacture diesel vehicles for commercial use, excavators, industrial shunted, dumpers, heavy forgings and machine tools.

The commercial diesel vehicles which were known „Tata Mercedes Benz (TMB) are now called „Tata vehicles after the expiry of the collaboration agreement with Daimler-Benz AG, West Germany. The company also used to manufacture pulp and paper making machinery.

From being present as an exporter in 70 countries, the company today focuses on 15-20 key countries where it will have a significant presence in terms of volumes and market shares. This\ complemented the existing product range of Tata Motors, which delivers vehicles up to 210 HP.

Analysis and interpretations

Leverage analysis

In finance, leverage is a general term for any technique to multiply gains and losses. Common ways to attain leverage are borrowing money, buying fixed assets and using derivatives. Important examples are:

- A public corporation may leverage its equity by borrowing money. The more it barrows, the less equity capital it needs, so any profits or losses are shared among a smaller based and proportionately larger as a result.
- A business entity can leverage its revenue by buying fixed assets. This will increase the proportion of fixed cost as opposed to variable costs; it states that a change in revenue will result in a larger change in operating income.

Types of Leverage

Operating leverage - The leverage associated with investment i.e., asset acquisition activities are called as operating leverage.

Formula to calculate operating leverage

$$\text{Operating Leverage} = \frac{\text{Contribution}}{\text{EBI}}$$

TABLE 1

OPERATING LEVERAGE

(Rs in Crores)

S.NO	YEAR	CONTRIBUTION	EBIT	RATIO
1	2009-2010	35373.29	3257.2	2.06
2	2010-2011	47088.44	3727.34	1.87

3	2011-2012	54306.56	3144.89	2.18
4	2012-2013	44765.72	1988.56	2.29
5	2013-2014	34319.28	851.58	2.34

Source: Annual Report

The above table 4.1 reveals that the contribution of the company was inclined during the study period. The operating leverage of the company was highest (2.34 times) in the year 2013-2014 and it was lowest (1.87times) in the year 2010-2011.

Financial leverage – The leverage associated with financing activities is called a financial leverage.

Formula to calculate financial leverage ratio:

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{EBT}}$$

TABLE 2

Financial Leverage

(Rs in Crores)

S.NO	YEAR	EBIT	EBT	RATIO
1	2009-2010	3257.2	2010.95	1.62
2	2010-2011	3727.34	2343.64	1.59
3	2011-2012	3144.89	1926.27	1.63
4	2012-2013	1988.56	600.8	3.30
5	2013-2014	851.58	485.94	1.75

Source: Annual Report

Table 2 states that the EBIT of the company was inclined during the study period. The financial leverage of the company was highest (3.30 times) in the year 2012-2013 and it was lowest (1.59 times) in the year 2010-2011.

Combined leverage – This is the product of the operating and financial leverages.

The Formula to Calculate Combined Leverage:

$$\text{Combined Leverage} = \text{Operating Leverage} \times \text{Financial Leverage}$$

TABLE 3**Combined Leverage**

(Rs in Crores)

S.NO	YEAR	OPERATING LEVERAGE	FINANCIAL LEVERAGE	RATIO
1	2009-2010	2.06	1.62	3.33
2	2010-2011	1.87	1.59	2.97
3	2011-2012	2.18	1.63	3.55
4	2012-2013	2.29	3.30	7.55
5	2013-2014	2.34	1.75	4.09

Source: Annual Report

It can be understood from the table 3 that the operating and financial leverage of the company was inclined during the study period. The composite / combined leverage of the company was highest (7.55 times) in the year 2012-2013 and it was lowest (2.97) in the year 2010-2011.

Findings of the study

- ❖ The operating leverage of the company was highest (2.34 times) in the year 2013-2014 and it was lowest (1.87 times) in the year 2010-2011. The
- ❖ financial leverage of the company was highest (3.30 times) in the year 2012-2013 and it was lowest (1.59 times) in the year 2010-2011
- ❖ The composite / combined leverage of the company was highest (7.55 times) in the year 2012-2013 and it was lowest (2.97) in the year 2010-2011.

Suggestions

- A high & low operating & financial leverage are very risky. A firm must maintain a proper balance between the two financial & operating leverage.
- The company should increase profit by reducing its selling price & cost of production.

Conclusion

The study was undertaken to analyze the leverage & financial performance of Tata motors 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 suggestion to overcome it. If the suggestions are implemented, the company can increase its profitability and overall performance.

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