



Study Of Leverage Of Reliance Retail India

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ABSTRACT

Investment decisions are one of the most important areas of financial decision making. It improves the selection of assets in which funds will be invested by a firm. The finance decision shows the proportionate relationship between debt and equity. The third / dividend decision shows the financing position of the company in the form of higher distribution of dividend to the share holders. Company can distribute higher dividend on the basis of maintaining the higher dividend policy. An appropriate dividend decision is totally based on the success of the first two decisions. This tool is used in the study to analyze the profitable proceeding of the Primary Reliance Retail India Ltd.

Keywords:- Dividend, Profitability, Capital Structure, Leverage, Decisions Capitalization, RIL

Introduction

In practice, the objective of every company is to increase the shareholders wealth. Shareholder's wealth maximization is helpful in maintaining balance between timing and the risk of expected benefits. These objectives can be achieved based on three major decision as well as functions of finance:-

- ❖ Investment decision
- ❖ Financing decision
- ❖ Dividend decision

In investment and financing decisions, it is the flow of cash that is important, not the accounting profits.

Retail Industry In India

The retail industry is the sector of economy which consists of individuals, stores, commercial complexes, agencies, companies, and organization, etc. It is involved in the business of selling or merchandizing diverse finished products or goods to the end

user consumers directly and indirectly. Goods and products of the retail industry or sector are the finished final objects/ products of all sectors of commerce and economy of a country. The US retail Industry is the world largest retail industry and it is still growing.

Retailing in India can be categorized as:-

- Unorganized Retailing
- Organized Retailing

Indian retail market is the 5th largest market in the world by economic value. The Indian retail sector is highly fragmented with more than 90% of its business being carried out by traditional family run small stores.

Meaning Of Leverage

Leverage

A company can finance its investments by debt and equity. The financial leverage employed by a company is intended to earn more return on the fixed charge funds than their costs.

In simple terms, leverage means the use of the fixed-charges sources of funds, such as debt and preference capital along with the owner's equity in the capital structure. The role of leverage is very important because of its impact on profitability of the company. Lower the interest rates, the greater will be the profit, and the less chance of loss. Less the amount borrowed, the lower will be the profit or loss. Greater the borrowing, greater is the risk of unprofitable leverage and greater chances of gain.

Types of leverage

- Operating leverage
- Financial leverage
- Composite leverage

Operating leverage

The operating leverage may be defined as the tendency of the operating profit to vary disproportionately with sales. It is assumed to exist when a firm has to pay fixed cost regardless of level of output or sales. Thus, the degree of operating leverage depends

upon the amount of fixed elements in the cost structure. Operating leverage in a firm is a function of these functions:

- Amount of fixed costs
- Contribution margin
- Volume of sales

Of course, there will be no operating leverage, if there are no fixed operating costs. Computation of operating leverage can be calculated by the following formula:-

$$\text{Operating Leverage} = \frac{\text{contribution}(C)}{\text{operating profit}(OP)}$$

Degree of operating leverage- It can be calculated as % change in the profits resulting from a % change in the sales.

$$\text{Degree of operating leverage} = \frac{\% \text{ change in operating profit}}{\% \text{ changes in sales}}$$

Financial leverage

The financial leverage may be defined as the propensity of the residual net income to vary disproportionately with operating profit. It indicates the charge that takes place in the taxable income as a result of change in the operating profit. It signifies the survival of fixed interest/ fixed dividend bearing securities in the total capital structure of the company's financial leverage can be calculated as follows-

$$\text{Financial leverage} = \frac{\text{Operating profit}}{\text{profit before tax but after interest}}$$

Composite leverage

Composite leverage thus, expresses the relationship between revenue on account of sales and the taxable income. In short, both the leverage are combined, the result obtained will disclose the effect of change in sales over change in taxable profit or EPS.

Composites leverage can be calculated as follows:-

$$\text{Composite leverage} = \text{operating leverage} \times \text{financial leverage}$$

Impact of leverage on profitability

It impact on market by two ways:-

1. When market is favorable:- when the funds are available at low rate of interest.
 - a. Firm earn more on assets purchased with the funds than the fixed costs of their use.
 - b. Risks are less
 - c. Cost of capital are less
 - d. Increase dividend payout ratio
 - e. Increase in value of fund
 - f. Easy of expansion in business
2. When market is unfavorable- Means when the firm doesn't earn as much as the fund cost.

Reason

- Borrowing capacity of firm is less.
- Not optimization of capital structure.
- Increase in fixed financial costs.

Research methodology

The data was collected from the annual reports of the company websites.

Time period of study

Period of Study: 2019 to 2023.

Hypothesis

- **Degree of leverage** and **EPS** are positively co-related in such a manner that increases financial leverage which leads to increase in EPS.
- Degree of operating leverage is positively correlated with EPS.
- Total leverage is positively correlated with EPS.

TECHNIQUES:-

To analysis the data, Pearson's correlation analysis and Student's "t" test technique is used.

Data Analysis

Table 1

Details regarding sales, EBIT, EBT, Net worth, loan and capital employed (Rs, million)

Year	Sales	EBIT	EBT	Net worth	Loan	Capital employed	Interest	Interest /loan
2019	5683370	1157540	380438	395880	118098	9.95	9751	8.2%
2020	5966790	1285240	350519	393540	194402	8.84	12105	6.2%
2021	4663070	1125150	264789	491280	160598	5.82	16211	10.09%
2022	6946730	1451840	437575	590440	167231	8.24	9123	5.4%
2023	8763960	1809120	551684	662840	135561	10.21	12633	9.3%
Total	32023920	6828890	1985005	2533980	775890	43.06	59823	39.19
Avg.	6404784	1365778	397001	506796	155178	8.612	11965	7.84%

Sources: computed from annual reports.

Explanation of Table 1

This table shows better performance in sales, EBIT, EBT have yielded better results during the study period. Net worth, loan, interest has increase due to the increase in the shareholders funds.

Table 2

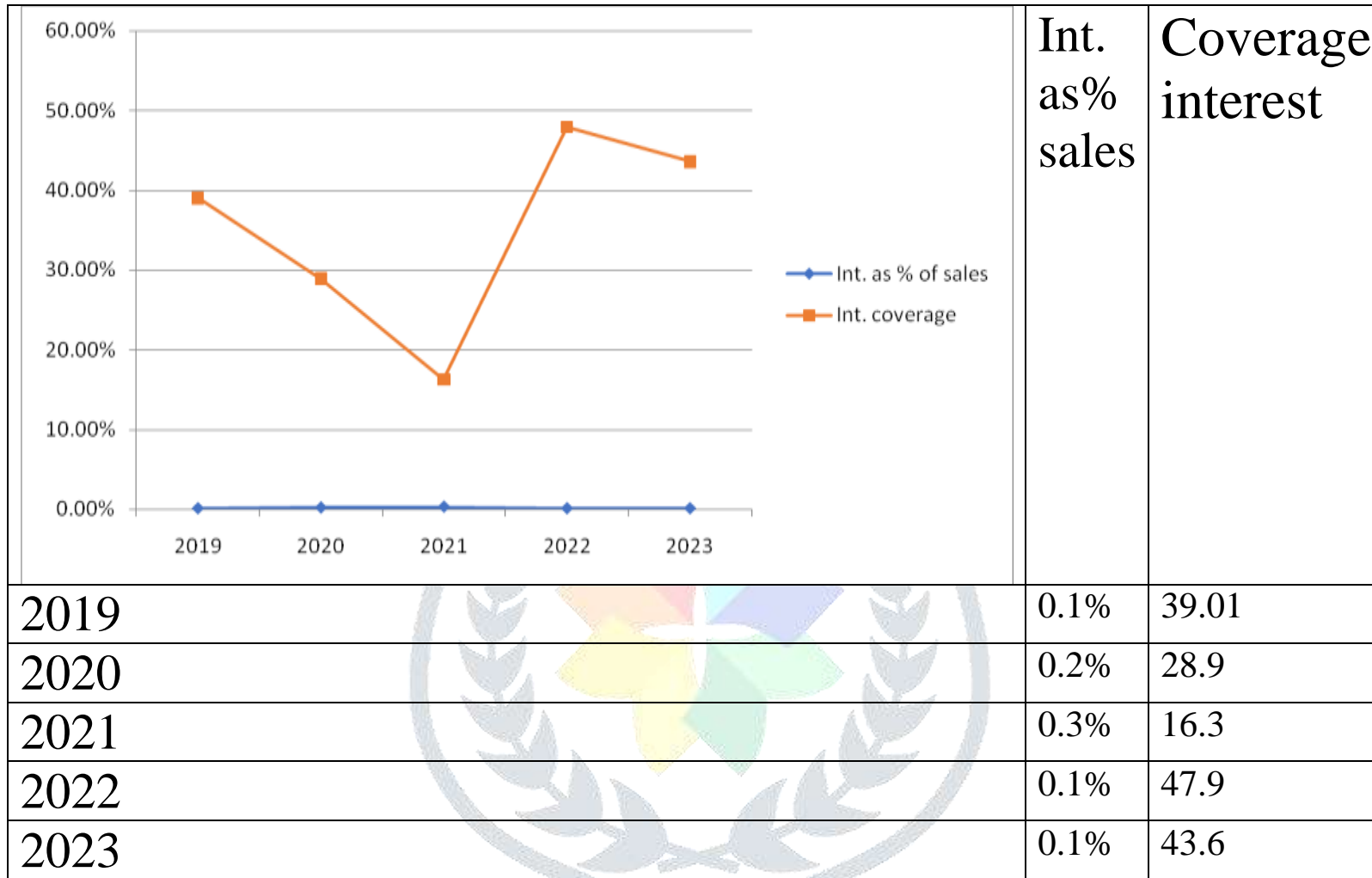
Cost of Interest and Interest Coverage

Year	Sales	EBI	Interest	Int. as% sales	Coverage interest
2019	5683370	1157540	9751	0.1%	39.01
2020	5966790	1285240	12105	0.2%	28.9
2021	4663070	1125150	16211	0.3%	16.3
2022	6946730	1451840	9123	0.1%	47.9
2023	8763960	1809120	12633	0.1%	43.6

Explanation table 2

Interest as a percentage of sales and interest coverage ratio are presented in table 2. It is evident from the table that due to better performance in sales and decreasing interest cost, interest rate as a percentage of sales has shown a decreasing tendency over the years and average interest as a percentage of sales was 2.31 during the first three years.





Interest as a percentage of sales and interest coverage ratio of Reliance Company

Table 3

Composite of Capital Structure

Year	Share capital	Revenue & surplus	Net worth	Debt	Capital employed	Debt equity ratio	% to net worth		% to capital structure		
							Share capital	Revenue & surplus	Share capital	Revenue & surplus	loan
2019	6338.69	398983	395880	118098	9.95	0.29	62.45	100.07	6.38	973	118
2020	6339.27	384875	393540	194402	8.84	0.49	62.07	97.79	704.36	42	216
2021	1056.06	468038	491280	160598	5.82	0.32	63.02	95.26	17.05	78	267
2022	6765.99	464762	590440	167231	8.24	0.28	87.26	78.71	7.51	58	185
2023	6766.09	472328	662840	135561	10.21	0.28	97.96	71.25	6.76	47	135

- % to net worth = $\frac{\text{share capital}}{\text{net worth}}$
- % to net worth = $\frac{\text{r\&s}}{\text{net worth}}$

Explanation

In the table 3, it is evident that company has good combination of debt equity policy and overall contribution of net worth to capital employed is average.

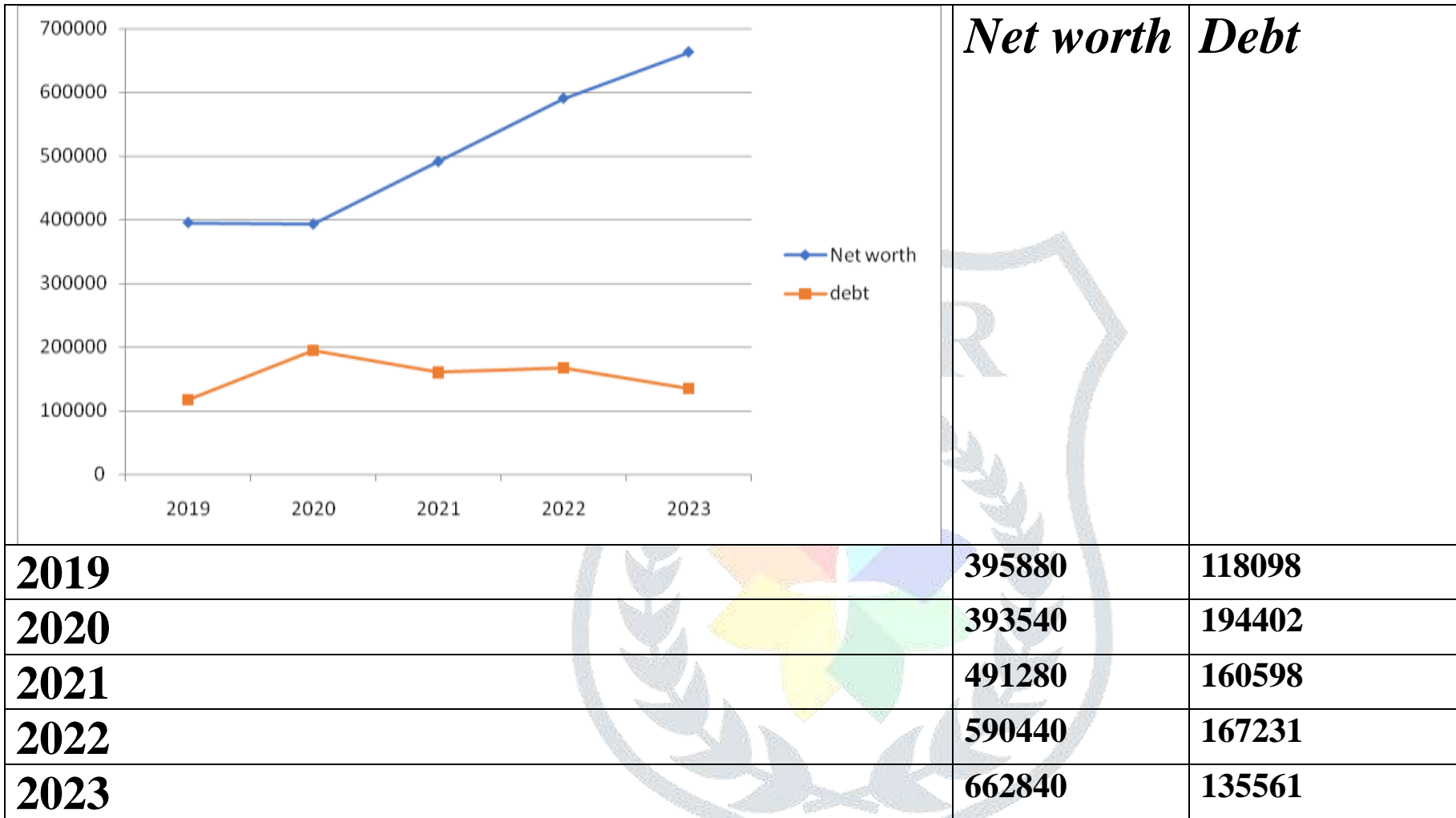


Table 4

Year	2019	2020	2021	2022	2023
Sales	5683370	5966790	4663070	6946730	8763960
EBIT	1157540	1285240	1125150	1451840	1809120
EBI	380438	350519	264789	437575	551684
DEGREE OF FINANCIAL LEVERAGE	2.92	3.26	2.29	2.45	2.72
DEGREE OF OPERATING LEVERAGE	0.20	0.21	0.24	0.20	0.20
TOTAL LEVERAGE	0.29	0.49	0.32	0.28	0.20
EPS	55.48	55.45	49.66	59.24	65.34

EXPLANATION

Table 4 shows the degree of financial leverage was almost consistent during the entire period of study. In case of operating leverage, the same tendency can be noticed but there was an increase in last year as compared to the initial year.

Conclusion

Leverage is an important asset/ source of finance for every company. There are various changes in retail which affects the market. Every company has to take all important financial, investment and dividend decision because of its effect on the financial profitability, risk, return, and goodwill of the company. It is also helpful in reducing the cheap cost of capital and easy availability of loan. Reliance Retail India ltd. can also use the financial leverage properly for huge growth of the company. If it is carried out, then the result would be growth of company and sky would be the limit then.

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