ORIGINAL RESEARCH PAPER

Commerce

IMPACT OF FINANCIAL LEVERAGE ON FIRM PERFORMANCE – AN INVESTOR PERSPECTIVE

KEY WORDS:

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INTRODUCTION

Financial leverage allows a firm to amplify its returns on equity investment. An investor can potentially earn higher returns on investment compared to investing in an unleveraged firm. In times of economic downturns or financial distress, high levels of debt can exacerbate financial difficulties and even lead to bankruptcy. Therefore, investors must carefully assess the risk-return tradeoff associated with leverage. The Fast-Moving Consumer Goods (FMCG) sector in India is highly competitive, with numerous players vying for market share. The market is expected to increase at a CAGR of 14.9% to reach US$ 220 billion by 2025, from US$ 110 billion in 2020. Financial leverage can provide FMCG companies with the necessary resources to invest in branding, advertising, and promotional activities to strengthen their market position. The FMCG industry stands as a dynamic and ever-evolving sector on the global economic stage. Renowned for its rapid pace, it encompasses a diverse array of products that people consume regularly, from packaged foods and beverages to personal care items and household essentials. Recently, the FMCG industry has witnessed transformation driven by technological advancements, sustainability imperatives, changing consumer behaviors, and the ongoing impact of globalization. These factors have spurred innovation, leading to the creation of eco-friendly packaging, the rise of e-commerce platforms, the advent of personalized products, and a heightened emphasis on health and wellness offerings.

Research Methodology

Financial leverage influences firm performance from an investor's perspective by affecting risk, return, cost of capital, profitability, growth potential, creditworthiness, dividend policy, and market perception. Management should also rely heavily on the corporation's assets to generate enough earnings to be added to its earnings, allowing them to service all its debt obligations Investors must carefully evaluate a company's capital structure and debt levels to assess its ability to generate sustainable returns and manage risks effectively (Richard Arhinful et al., 2023). The research objectives of the study are, (i) To analyze the relationship between financial leverage and profitability of the FMCG industry, (ii) To examine the determinants of firm performance and (iii) To assess the impact of financial leverage on firm performance in Investors perspective. The samples selected for the study are listed top ten FMCG companies in India. The research sample comprises the top ten FMCG companies, Tata consumer products, Nestle India, Indian Tobacco Company, Hindustan Unilever, Marico, Emami, Dabur India, Godrej Industries, Britannia and Wipro Consumer Care, based on their average annual sales value which exceeds 1000 crores. The published annual reports of the companies covering a period of ten financial years from 2013-2014 FY to 2022-2023 FY were analyzed. The study aimed at offering suggestions to potential investors while making investments in FMCG industry to manage their portfolio.

ANALYSIS AND INTERPRETATION

Descriptive statistics

Table 1 Descriptive Statistics

	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
LTDE	10	9.62	.03	9.65	1.618	1.037	3.279	10.755	2.156	.687	3.992	1.334
DE	10	8.11	.03	8.14	2.855	.861	2.724	7.422	1.133	.687	.428	1.334
Current Ratio	10	2.91	.15	3.06	1.621	.259	.819	.671	.283	.687	.895	1.334
Quick Ratio	10	3.69	.17	3.86	1.344	.330	1.043	1.089	1.721	.687	3.560	1.334
Propreitary	10	.65	.02	.67	.325	.066	.210	.044	.451	.687	-.568	1.334
Reserves	10	4.62	.16	4.78	1.322	.567	1.795	3.225	1.538	.687	.817	1.334
Growth	10	1.04	.07	1.11	.309	.120	.382	.146	1.678	.687	1.441	1.334
Solvency	10	9.27	.08	9.35	1.590	.892	2.821	7.960	2.807	.687	8.216	1.334
Size	10	4.72	.07	4.79	3.373	.567	1.794	3.221	-1.523	.687	.902	1.334
ROA	10	157.73	.02	157.75	15.970	15.753	49.816	2.482	3.162	.687	10.000	1.334
ROE	10	8.33	.07	8.40	1.113	.812	2.568	6.595	3.127	.687	9.833	1.334
EPS	10	13.45	.15	13.60	4.703	1.529	4.836	23.392	.531	.687	-1.002	1.334
Valid N (listwise)	10											

Source : Computed Data

The mean LTDE is 1.6180 with a standard deviation of 1.0370. The distribution exhibits significant right-skewness 3.2794) and moderately heavier tails than a normal distribution (Kurtosis = 1.334). Mean DE ratio is 2.8550 with a deviation of 0.86150. Mean current ratio is 1.6210 with a deviation of 0.25909. The distribution appears closer to normal with moderate skewness 0.81930. Mean quick ratio is 1.3440 with a deviation of 0.33000. Mean growth rate is 0.3090 with a standard deviation of 0.12091. Mean size is 3.3730 with a deviation of 0.56754. Mean ROA is 15.9700 with a standard deviation of 15.753. Mean ROE is 1.1130 with deviation of 0.81212. Mean EPS is 4.7030 with a deviation of 1.52943.

Relationship Between Financial Leverage And Profitability Of The FMCG Industry – Correlation Analysis

Table 2 Correlation Results

			LTDE	DE	ROA	ROE	Reserves
Spearman's	LTDE	Correlation Coefficient	1.000	-.079	-.030*	-.140	.358
		Sig. (2-tailed)	.	.829	.934	.700	.310
		N	10	10	10	10	10
	DE	Correlation Coefficient	-.079	1.000	-.334	-.444	.018*
		Sig. (2-tailed)	.829	.	.345	.199	.960
		N	10	10	10	10	10
	ROA	Correlation Coefficient	-.030*	-.334	1.000	.220	-.140
		Sig. (2-tailed)	.934	.345	.	.542	.700
		N	10	10	10	10	10
	ROE	Correlation Coefficient	-.140	-.444	.220	1.000	.225
		Sig. (2-tailed)	.700	.199	.542	.	.532
		N	10	10	10	10	10
	Reserves	Correlation Coefficient	.358	.018*	-.140	.225	1.000
		Sig. (2-tailed)	.310	.960	.700	.532	.
		N	10	10	10	10	10

H_o: There is no significant the relationship between financial leverage and profitability in the FMCG industry

The results indicate weak correlations with statistical significance at the 0.05 level. Specifically, LTDE shows weak correlations with DE (-0.079), ROA (-0.030), and ROE (-0.140), while exhibiting a moderate correlation with Reserves (0.358). DE displays a weak negative correlation with LTDE (-0.079), and moderate correlations with ROA (-0.334) and ROE (-0.444). Furthermore, ROA demonstrates weak negative correlations with LTDE (-0.030) and DE (-0.334), along with positive correlations with ROE (0.220). Reserves exhibit a positive correlation with LTDE (0.358) and weak correlations with DE (0.018), ROA (-0.140), and ROE (0.225). Overall, the analysis suggests that within the FMCG industry, there are weak associations between (LTDE and DE) and (ROA and ROE). A moderate positive relationship between reserves and LTDE, indicates that companies with higher long-term debt to equity ratios tend to have higher reserves. Hence the null hypothesis is rejected.

II. Examine The Determinants Of Firm Performance – Regression Analysis

H_o: There are no significant determinants of firm performance in the FMCG industry

Table 3a Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.994[a]	.988	.965	8.77624

a. Predictors: (Constant), SR, ROA, CR, ROE, DER, LTDR

Table 3b ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	19605.978	6	3267.663	42.425	.005[a]
	Residual	231.067	3	77.022		
	Total	19837.045	9			

a. Predictors: (Constant), SR, ROA, CR, ROE, DER, LTDR

b. Dependent Variable: EPS

Table 3c Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	2.677	19.462		.138	.899
	DER	-.534	.199	-.278	-2.679	.075
	LTDR	340.460	104.889	.717	3.246	.048*
	ROA	-68.747	55.325	-.147	-1.243	.302
	ROE	-3.296	1.523	-.179	-2.164	.119
	CR	5.760	5.819	.082	.990	.395
	SR	17.026	16.306	.228	1.044	.373

a. Dependent Variable: EPS

The regression model for EPS also shows a high degree of explanatory power, with an R-square value of 0.988 and an adjusted R-square of 0.965. The standard error of the estimate is 8.77624. The ANOVA table reveals that the regression model is significant at p = 0.005, indicating that the predictors collectively have explanatory power in predicting EPS. Among the predictors, LTDR emerges as statistically significant, with a positive effect on EPS (Beta = 0.717, p = 0.048). DER shows a negative effect that is marginally significant (Beta = -0.278, p = 0.075). In summary, the regression analyses provide insights into the determinants of firm performance. Reserves appear to positively influence ROE, while LTDR positively affects EPS. Hence the null hypothesis is rejected.

III. Impact Of Financial Leverage On Firm Performance In Investors Perspective – ANOVA Analysis

H_o: There is no significant impact of financial leverage on firm performance in the FMCG industry

Table 4 ANOVA Results

		Sum of Squares	df	Mean Square	F	Sig.
DER	Between Groups	5250.603	7	750.086	14.265	.067
	Within Groups	105.166	2	52.583		
	Total	5355.769	9			
LTDR	Between Groups	.040	7	.006	.234	.939
	Within Groups	.048	2	.024		
	Total	.088	9			
ROE	Between Groups	58.166	7	8.309	209.703	.005*
	Within Groups	.079	2	.040		
	Total	58.246	9			
CR	Between Groups	3.956	7	.565	15.591	.062
	Within Groups	.073	2	.036		
	Total	4.029	9			
SR	Between Groups	1.584	7	.226	.229	.941
	Within Groups	1.976	2	.988		
	Total	3.560	9			
EPS	Between Groups	8549.911	7	1221.416	.216	.947
	Within Groups	11287.134	2	5643.567		
	Total	19837.045	9			

a. Dependent Variable: ROA

The ANOVA results shed light on the impact of financial leverage on firm performance from an investor's perspective. While DER demonstrates a noteworthy difference in firm performance across different groups (p = 0.067), it falls marginally above the conventional significance threshold of 0.05. ROE exhibits a highly significant difference across groups (p = 0.005), highlighting its sensitivity to factors associated with financial leverage, making it a crucial performance indicator for investors. SR and EPS do not show significant differences across groups (SR: p = 0.941, EPS: p = 0.947), suggesting minimal influence of these metrics on firm performance from an investor's perspective. Overall, while DER and CR may play a role in firm performance, particularly evidenced by their impact on ROE, further analysis and consideration of additional factors are warranted for a comprehensive understanding of the relationship between financial leverage and firm performance. Hence the null hypothesis is rejected.

CONCLUSION

Financial leverage plays a significant role in shaping a firm's performance and can have both positive and negative implications for investors. Since leveraging up can increase a firm's value by reducing the weighted average cost of capital. Industrial companies may enhance the profitability of their firms by minimizing debt, and increasing financial assets compared with total assets (Nawaf Ahmad Salem AlGhusin 2015). However, excessive leverage can lead to financial instability and lower valuation. FMCG companies focused on agility, consumer-centricity, and responsible business practices to thrive in a competitive and ever-changing marketplace. By 2025, the industry is expected to reach nearly $220 billion, with a growth rate of 14.7%. The study reveals ROE and EPS to be a crucial performance indicator for potential investors of FMCG industry, followed by DER and CR. It indicates that companies with higher long-term debt to equity ratios tend to have higher reserves and a further increase would reduce the ROA. Rising trends in profitability, debt ratio, and current ratio can be viewed as positive indicators for investment decisions and wealth maximization. By carefully assessing the risk-return tradeoff, the impact on valuation, and monitoring debt practices, investors can make decisions to maximize returns while mitigating risks associated with leverage.

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