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A STUDY ON LEVERAGES OF HINDUSTAN UNILEVERLIMITED

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Abstract

The word leverage refers to an increased means of accomplishing some purpose. Leverage is used to lifting heavy objects, which may not be otherwise possible.

In the financial Management, leverage refers to furnish the ability to use fixed cost assets or funds to increase the return to its shareholders.

According to James Horne "The employment of an asset or fund for which the firm pays a fixed cost or fixed return". Leverages results as results of organisation employing an asset which has fixed cost.

In this study the leverages of Hindustan Unilever limited has studied to know the impact of leverages on the financial status of the company.

Introduction:

The Leverages are mainly classified into 3 types

Operating leverage

Financial leverage

Combined leverage

Operating Leverage:

The leverage associated with investment activities is called as operating leverage. It is happens due to fixed operating expenses in the firm . Operating leverage may be defined as the firm's ability to use fixed operating costs to magnify the effects of changes in sales on its operating profit.

Operating leverage consists of two important costs viz., fixed cost and variable cost. When the company is said to have a high degree of operating leverage if it employs a great amount of fixed cost and smaller amount of variable cost. Thus, the degree of operating leverage depends upon the amount of various cost structure. Operating leverage can be determined with the help of a break even analysis. Operating leverage can be calculated with the help of the following formula:

Operating leverage = contribution / EBIT

Contribution and EBIT calculated by using following formula:

Sales = xxx

(-) variable cost = xxxx

= contribution

(-) fixed cost = xxxx

= EBIT or operating profit

Operating leverage may be favorable or unfavorable. if contribution becomes more than fixed then it is favorable situation or else it will be unfavorable. That's why operating leverage is called as double-edged sword.

Degrees of operating leverage:

The Degree of operating leverage is defined as "percentage change in earnings before interest and tax (EBIT) or operating profit due to the change in percentage change in sale".

Formula: Degree of operating leverage = percentage change in operating profit/percentage change in sales

Importance of operating leverage:

The operating leverage explains the impact of change in sales on operating profit or earnings before interest and tax.

If operating leverage of company is high, it means the impact of minute change in sales would leads to high change in operating profit.

Generally, firms would not go for higher operating leverage because it causes higher changes in operating profit both favorably and unfavorably.

Financial leverage: Financial leverage simply means the presence of debt in the capital structure of a firm. Similarly, in other words, we can also call it the existence of fixed-charge bearing capital which may include preference shares along with debentures, term loans etc .

FINANCIAL LEVERAGE FORMULA

FL = percentage change in EBIT / Percentage change in sales

Financial leverage as trading on equity:

Financial leverage sometimes defined as trading on equity. Trading on equity means using debt, bonds, and preferred stock to rise the earnings on equity i.e., common stock.

Favourable and unfavourable financial leverage:

Financial leverage is a double-edged sword because it may reduce the cost of capital (ko) which is significant in profit making of every firm and financial leverage may lead to bankruptcy.

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In simple words if cost of capital is less than the returns earned by company it is said to be in favourable situation and if cost of capital is high as compared to return earned by company than it is said to be in unfavourable.

Degree of financial leverage: The degree of financial leverage explain the percentage change in the Earning per Share (EPS) due to the change in percentage change in the EBIT.

FORMULA FOR DEGREE OF FINANCIAL LEVERAGE:

DFL = percentage change in EPS / percentage change in EBI0

Combined leverage:

Combined leverage is also known as composite leverage and total leverage. It is combination of financial and operating leverage.

Combined leverage shows the relationship between variations in taxable income due to corresponding change in sales.

FORMULA FOR COMBINED LEVERAGE:

CL = CONTRIBUTION / EBIT

Degree of combined leverage:

Degree of financial leverage is multiplication of degree of financial leverage and degree of operating leverage. Degree of combined leverage explains the optimum level of financial and operating leverage.

FORMULA FOR DEGREES OF COMBINED LEVERAGE:

DCL = DOL* DFL

DCL = Percentage change in EBIT/ percentage change in sale * percentage change in EPS / percentage change in EBIT

IMPORTANCE OF LEVERAGES:

Financial experts of the company mostly use operating leverage and financial leverages as qualitative tools to measure and analyses the return to the firm and equity share present market price.

In these three main leverages the financial leverage is considered to be superior since it focuses more on market price of shares and net worth of the company. The management will go for trading on equity

Measuring operating:

Leverages are useful in measuring operating risk because larger the fixed cost will lead to higher degree of operating leverage.

Measurement of financial risk:

Financial risk is nothing but risk of non-covering fixed financial cost of a firm due to the un availability of funds.

Measuring risk:

The multiplicative relationship between financial leverage and combined leverage will give us the total leverage which is called as combined leverage and combined leverage is useful for understanding the optimum level of leverage.

Optimum level of leverage is finally useful in measuring total risk.

Making optimum level of capital structure:

By using financial leverage the financial expert is able to fix the appropriate level of debt which finally leads to the designing and maintaining the capital structure of the firm.

Increase profitability:

By using leverages company can maximize the utilization of fixed capital which leads to the increment in profitability of the firm.

Objective of the study:

To understand the leverage ratios of company.

To determine the financial risk of the company

To find out the leverages

a) operating leverage

b) financial leverage

c) Combined leverage

To determine the strength and weakness of leverages

Research Methodology:

Research type:
It is a secondary data based research and an analytical research.
Here the data is taken from financial statement of the company from following year.
2016, 2017, 2018, 2019, 2020

Types of data:

Secondary data is taken from annual reports of the company from 2016 to 2020 . The other important information is extracted from several sources like,

Books

Company website

Financial data websites

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Company profile:

Hindustan Unilever Limited (HUL) is India's major Fast Moving Consumer Goods company with a legacy of over 8 decades in India. On any given day, nine out of ten Indian families" use our products to feel good, look good and get more out of life – generous us a unique opportunity to build a brighter future".

Brands around the world

HUL works to create a enhanced future every day and helps people feel good, look good and get more out of life with brands and services that are good for them and good for others.

With above 35 brands straddling 20 distinct types such as

Soaps,

Detergents,

Shampoos,

Skin care,

Toothpastes,

Deodorants,

Cosmetics,

Tea,

Coffee,

Data analysis:

Operating leverage:

Operating leverage is measured using the percentage change in EBIT and percentage change in sales of the company

Mathematical formula for operating leverage:

OL = percentage change in EBIT/ percentage change in sales

by using above formula, the result for Operating leverages in 5 years are as follow

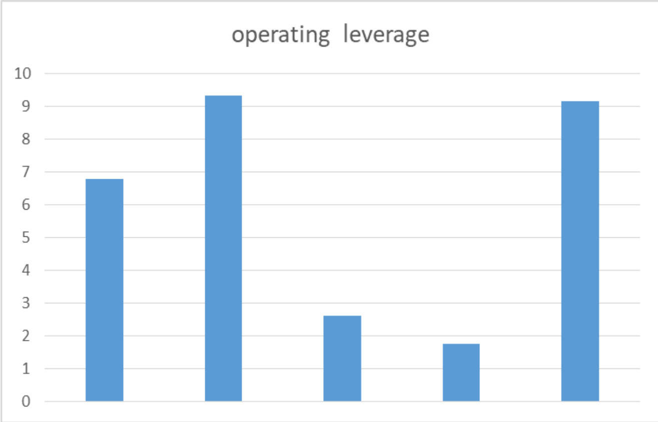
In 2020 it is 9.16.

In 2019 it is 1.75

In 2018 it is 2.6

In 2019 it is 9.3

In 2017 it is 6.3



Financial leverage:

Financial leverage is measured through percentage change in Earning Per Share (EPS) and percentage change in operating profit i.e. EBIT.

Mathematical formula for financial leverage:

Financial leverage = % change in EPS / % change in EBIT

By using the above formula if we calculate financial leverage the results will be as follow

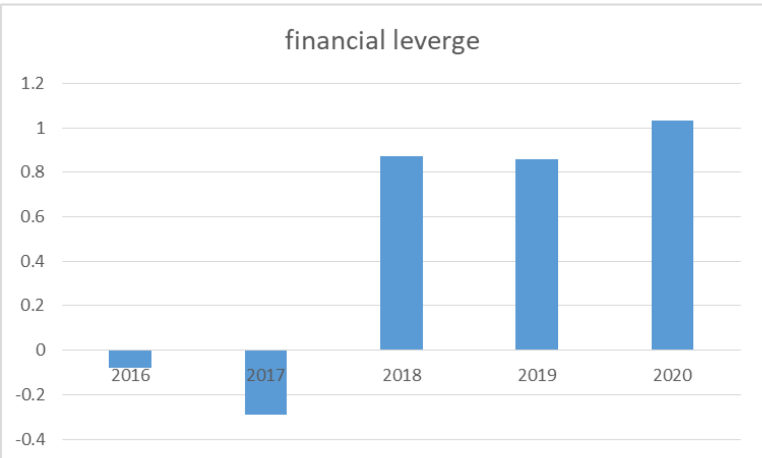
In 2020 financial leverage is 1.03

In 2019 financial leverage is 0.86

In 2018 financial leverage is 0.87

In 2017 financial leverage is -0.29

In 2016 financial leverage is -0.89



Combined leverage:

Combined leverage is calculated using multiplication of financial leverage and operating leverage.

Mathematical formula for combined leverage:

Combined leverage = financial leverage * operating leverage

The operating leverage according to the results are as follow

In 2020 operating leverage is 9.43

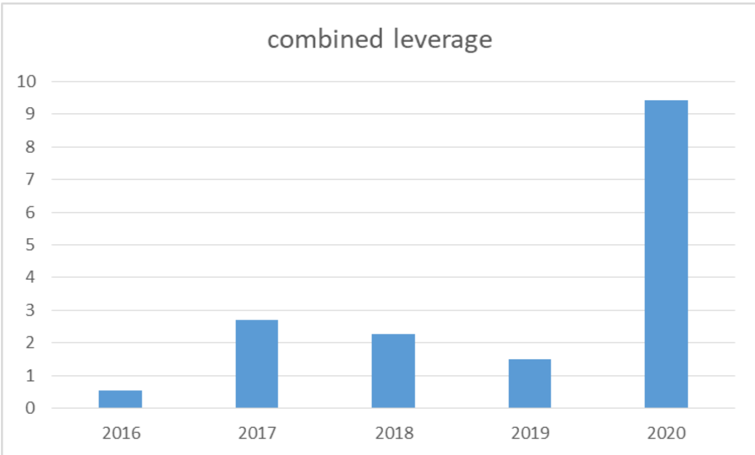
In 2019 operating leverage is 1.5

In 2018 operating leverage is 2.26

In 2018 operating leverage is 2.26

In 2017 operating leverage is 2.69

In 2018 operating leverage is 0.54



Findings:

The degree of operating leverage of the company has changed through the years

In 2020 the degree of operating leverage is 9.16 which means the change in sale will show high impact on the profitability of the company.

In 2019, 2018 the degree of operating leverage is low as compared to other years which means risk of deviation from profit is comparatively less

Higher level of financial leverage indicates the risk of change in the profitability of the company in the leverage of the firm.

In 2020 the degree of financial leverage is high compared to the other years which means the change in leverage would lead to the change in profitability of the company as compared to other year.

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