

## Impact of Leverage on Financial Performance of S&P SL Companies

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### **Abstract**

**Purpose:** The management's choice of the best capital structure level to increase the wealth of shareholders is a crucial financial decision. The managers borrow money to be able to boost the stockholders' return, and when management borrows a lot of money, the firm's costs and risks related to its finances go up. The influence of three different leverage types, namely degree of financial leverage, degree of operating leverage, and degree of combined leverage, on the financial performance of S&P SL companies listed on the CSE, was examined in this study.

**Design/Methodology/Approach:** The S&P SL 20, the twenty largest and most liquid businesses in the Sri Lankan equity market (based on market capitalization) for the years 2015–2020 was the study's sample. ROA (Return on Assets) and TOBIN'S Q were chosen for the study as the dependent variables to quantify the firm's financial performance. For measuring leverage, the independent variables were DFL (Degree of Financial Leverage), DOL (Degree of Operating Leverage), and DCF (Degree of Combined Leverage). For examining how leverage affects financial performance, the random effect penal regression model was chosen.

**FINDINGS-** The findings of this study showed that leverage significantly affects S&P SL's financial performance. According to the study's conclusions, managers of businesses should reduce fixed expenses and concentrate on boosting sales instead.

**Practical Implications:** This study helps researchers in identifying the impact of leverage on the financial performance of S& P SL companies. Additionally, the findings of this study can facilitate managers to take the best capital structure decisions to maximize the wealth of the shareholders.

**Research Limitations:** This research has covered a sample of S&P SL 20 which is the twenty largest and most liquid companies in the Sri Lankan equity market (based on market capitalization) and collected data for six years period. The task of collecting and analyzing data for all companies was very difficult and impracticable. The data collection was restricted by published annual reports in CSE. This study was restricted to three independent variables to measure the leverage and two dependent variables to measure the financial performance.

**Originality Value:** The findings of the study can contribute to investigating the impact of leverage on financial performance. Given that, the findings of this

research would be significant to the following groups specifically the government, the company's board of directors, management of S&P SL companies, stakeholders and investors, and finally to a theoretical critique. Last but not least the study contributes to knowledge in the field of finance and related studies. The study findings from this study may also be used to serve as reference materials by researchers and academicians in guiding future studies with respect to the impact of leverage on the financial performance of S&P SL companies.

***Keywords: Degree of Financial Leverage, Degree of Operating Leverage, Degree of Combined Leverage, Return on Assets, TOBIN'S Q, S&P SL companies***