



SNS College of Technology

Coimbatore - 35



23BAT611- Financial Management

Unit - III

COST OF CAPITAL & CAPITAL STRUCTURE



Presented by

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Design Thinker

1st Indian Institution to Implement Design Thinking Curriculum
Redesigning Common Mind and Business Towards Excellence



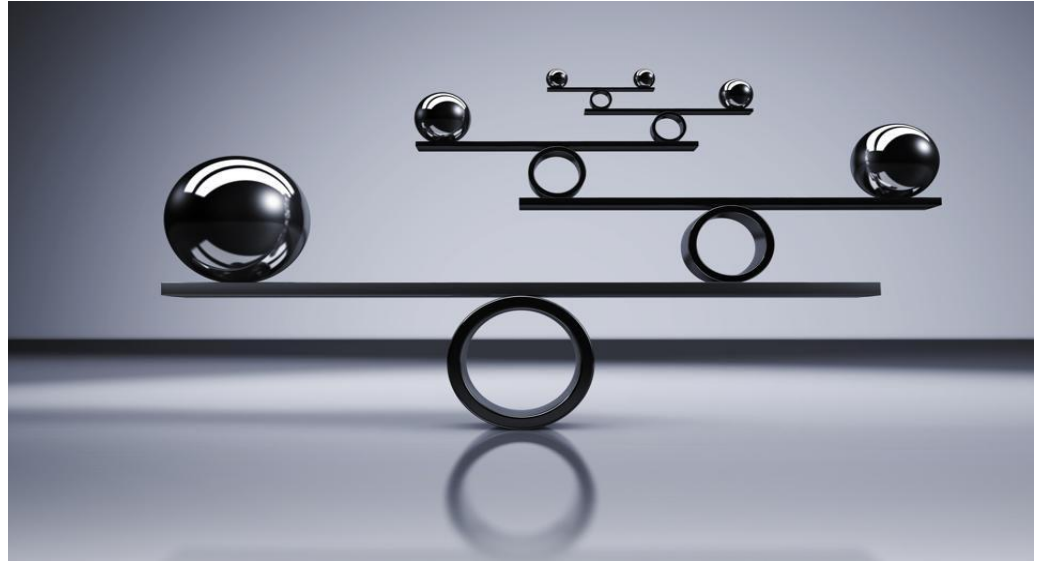
Recall



Discussed Problem related to Equity Share capital and retained earning



Topic





Leverage



Leverage.





Leverage

Statement of Profit

Particulars	Amount (Rs)
Sales	XXXX
Less : Variable Costs	XXXX
Contribution	XXXX
Less : Fixed Costs	XXXX
Operating Profit (EBIT)	XXXX
Less : Interest	XXXX
Profit Before Tax (PBT) EBT	XXXX



Leverage



Formula for Leverage

- a) **Operating Leverage = Contribution / Operating Profit (or) Contribution / EBIT**
- b) **Financial Leverage = Operating Profit / Profit Before Tax (or) Contribution / EBT**
- c) **Combined Leverage = Operating Leverage * Financial Leverage**



Leverage



Problem : 1

Calculate the operating financial and combined leverages from the following information.

Sales Rs. 50,000, Variable Costs Rs. 25,000, Fixed Costs Rs. 15,000, Interest Rs. 5,000.



Leverage

Statement of Profit

Particulars	Amount (Rs)
Sales	50,000
Less : Variable Costs	25,000
Contribution	25,000
Less : Fixed Costs	15,000
Operating Profit (EBIT)	10,000
Less : Interest	5,000
Profit Before Tax (PBT) EBT	5,000



Leverage



Formula for Leverage

- a) **Operating Leverage = Contribution / Operating Profit (or) Contribution / EBIT**
- b) **Financial Leverage = Operating Profit / Profit Before Tax (or) Contribution / EBT**
- c) **Combined Leverage = Operating Leverage * Financial Leverage**



Leverage - Solution

Formula for Leverage

a) **Operating Leverage = Contribution / Operating Profit (or) Contribution / EBIT**

$$\text{Operating Leverage} = 25,000 / 10,000 = 2.5 \text{ Times}$$

b) **Financial Leverage = Operating Profit / Profit Before Tax (or) Contribution / EBT**

$$\text{Financial Leverage} = 25,000 / 5,000 = 2 \text{ Times}$$

c) **Combined Leverage = Operating Leverage * Financial Leverage**

$$\text{Combined Leverage} = 2.5 * 2 = 5 \text{ Times}$$



Leverage

Problem : 2

The operating and Cost data of Ashok Ltd. Are as follows:

Sales 40,000 Units at 10 per Unit.

Variable cost at Rs 7.50 per Unit.

Fixed Cost Rs. 80,000 (including 15% interest on Rs. 2,00,000)

Calculate the operating, financial and combined leverages.



Leverage

Statement of Profit

Particulars	Amount (Rs)
Sales (40,000*10)	400,000
Less : Variable Costs (40,000*7.50)	300,000
Contribution	100,000
Less : Fixed Costs (80,000 – 30,000) (15% on 2,00,000)	50,000
Operating Profit (EBIT)	50,000
Less : Interest	30,000
Profit Before Tax (PBT)	20,000



Leverage - Solution

Formula for Leverage

a) **Operating Leverage = Contribution / Operating Profit (or) Contribution / EBIT**

$$\text{Operating Leverage} = 1,00,000 / 50,000 = 2 \text{ Times}$$

b) **Financial Leverage = Operating Profit / Profit Before Tax (or) Contribution / EBT**

$$\text{Financial Leverage} = 50,000 / 20,000 = 2.5 \text{ Times}$$

c) **Combined Leverage = Operating Leverage * Financial Leverage**

$$\text{Combined Leverage} = 2 * 2.5 = 5 \text{ Times}$$



Summarize



Leverage



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