

Chapter - 6

Leverage

[10 Marks]

Types of leverage

Operating leverage or Degree of Operating leverage (DOL)

Financial leverage or Degree of Financial leverage (DFL)

Combined leverage or Degree of combined leverage (DCL)

Taking advantage of operations of business i.e., operating fixed cost

Taking advantage of financial structure of business i.e., fixed cost of finance - Interest

Taking advantages of both operations and financial structure of business i.e., fixed cost of operations (+) fixed cost of finance.

By increasing Sales by a certain % we want to increase EBIT by a greater %.

By increasing EBIT by a certain % we want to increase EPS by a greater %.

By increasing Sales by a certain % we want to increase EPS by a greater %.

$$1) DOL = \frac{\% \text{ Ch. in EBIT}}{\% \text{ Ch. in Sales}}$$

$$DFL = \frac{\% \text{ Ch. EPS/EBT}}{\% \text{ Ch. EBIT}}$$

$$DCL = \frac{\% \text{ Change in } \frac{EOT}{PAT/EPST}}{\% \text{ Change in Sales}}$$

OR

OR

OR

In other words, we are measuring the impact of Fixed Costs

In other words, we are measuring the impact of Interest cost

In other words, we are measuring the impact of both Fixed Cost & Interest Cost

$$2) DOL = \frac{\text{Contri}}{EBIT}$$

$$DFL = \frac{EBIT}{EBT}$$

$$DCL = \frac{\text{Contribution}}{EBIT}$$

OR

OR

$$= \frac{EBIT}{EBIT - \text{Int} - \frac{PD}{1 - \text{Tax}}}$$

$$= DOL \times DFL$$

[In case PD is given]

Important Questions

Practical Q 4, 6, 9, 8, 10

PY Nov 19, 22

Jan 21

Dec 21