

Operating and Financial Leverages and Their Effects on Equity Valuation

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ABSTRACT: The purpose of this paper is to analyze the relationship between the leverage ratio and earnings as well as changes in share price in the banking companies in the context of Bangladesh. This paper empirically examines the effect of both operating and financial leverage on selected indicators of corporate profitability as well as share prices on a particular date. To conduct such empirical examination, a sample of 30 listed banking companies has been selected and information about these companies has been collected from their published annual reports for the years 2010, 2012 and 2013. A theoretical model has been applied to establish a relationship between leverage and profitability as well as stock prices. Descriptive statistics has been used to analyze the relationship among leverage, earnings and share price movements. This study shows that leverage has significant impact on stock holders return and the valuation of equity. It has also been found that leverage can express the quality and stability of the income stream. Income streams of highly levered firm are more volatile than the income streams of low levered firm. Operating liability leverage and financial leverage have solid impact on RNOA and ROCEs measure, stability and quality.

KEYWORDS: Financial Leverage, Operating Leverage, Shareholders' Equity

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I. INTRODUCTION

Profitability is how much a firm can earn by utilizing its resources. Profitability is achieved from operating excellence and smart asset management. Operating profitability can be identified from RNOA (Return on Net operating asset) and firms' profitability can be measured by ROCE. These profitability measures are derived by different variables and leverage is an important driver. It is expressed as the ratio between financial obligation and equity. In finance leverage acts as a determiner of risk and return. Leverage can also provide information about profitability and quality of profitability thus value of the equity (Penman, 1997). The standard measure of leverage is total liabilities to equity. However, while some liabilities like bank loans and bonds issued are due to financing, other liabilities like trade payables, deferred revenues, and pension liabilities result from transactions with suppliers, customers and employees in conducting operations. In this paper it will be attempted to understand the impact of leverage on profitability. How leverage impact on different drivers of profitability will also be observed. At present Bangladeshi capital market is experiencing a sluggish trend. So by this work will attempt to understand how leverage affects the banking industry. How operating and financial leverage affect profitability, how companies use their low cost operating leverage to finance their asset and lever their profitability can also be observed here. Empirical data will show the affect and influence of the leverage on profitability and value of equity. This paper has been divided into 6 chapters. In the introductory chapter, a brief overview of the overall paper accompanying the outline has been provided. In the next chapter, the research objectives of this paper will be enumerated. Chapter 3 provides a review of related literatures and chapter 4 discusses the methodology used for analyzing the data as well as establishing findings. Chapter 5 will include the theoretical foundation of the study. Chapter 6 and Chapter 7 will discuss the findings and conclusions respectively.

II. RESEARCH OBJECTIVES

The Study aims at achieving the following objectives:

- To understand the impact of leverage on profitability and the value of equity.
- To observe the nature and extend of leverage in the financial industry of Bangladeshi capital market.
- To highlight the relationship between leverage and shareholders' return
- To evaluate the dependency of leverage on shareholders' return.

III. LITERATURE REVIEW

Several studies have been conducted on capital structure by different scholars in different period of time. Historical studies conducted by (Miller, 1977; Myers S. C., 1984; Sheel, 1994) suggest that financial Leverage induces cost of capital, at last incline firms profitability and stock price. In a seminal work, (Myers, 1977) explained the impact of externalities caused by debt capital on shareholders investment strategy. He proposed that debt forces shareholder and management to invest in positive NPV(net present value) projects so that the benefits accrue to the shareholders . It was concluded that highly levered firms are less inclined to exploit opportunities than the firms with relatively low levels of leverage.(Aivaziana, Geb, & Qiuc, 2005) found that leverage is negatively related to the level of investment, and that this negative effect is significantly stronger for firms with low growth opportunities than those with high growth opportunities. Moreover, (Amsaveni, 2009) found that there exists a negative relation between leverage and future growth. (Baker, 1973) analyzed that effect of financial leverage or relatively greater use of debt capital, on industry profitability. Further literature has emerged which examines practices and issues relating to the recent development of a unique as well as common set of framework for dissemination of corporate financial information regarding capital structure. This section provides a review of both aspects. The role of leverage in magnifying the return on the shareholder is based on the assumptions that the fixed charges fund can be obtained at a cost lower than the firm's rate of return on net assets. Wald (1999) argued that debt capital has significant negative impact on the firm profitability. He conducted his study on the firm's capital structure which operates in United State, United Kingdom, Japan, France, and Germany. He applied firm size, growth and firm's riskiness as explanatory variables. In the similar manner, Mandelker & Rhee (1984) established that most profitable firms often have low leverage ratios and further explained that leverage increasing events such as stock repurchase or debt for equity exchange significantly affect firms stockholder's positive returns. Thus when the difference between the earnings, generated by assets financed by the fixed charges funds, and costs of these funds is distributed to the shareholders, then EPS increases. Chandrakumar & Govindasamy (2010) analysed and explained the effect of leverage on the profitability of the firm by investigating the relationship between the leverage and the earning per share. Ezeoha (2008) analyzed the impact of the firm size on corporate financial leverage from an undeveloped market perspective. It should be clear that EPS is the important figure for analyzing the impact of leverage. So, the researchers want to justify whether the leverage effect the shareholders' return or not practically by an evaluative study. Nissim & Penman (2003) presented a financial statement analysis that distinguishes leverage arisen from financing activities from leverage arisen from operating activities. The paper therefore concludes that balance sheet line items for operating liabilities are priced differently than those dealing with financing liabilities. Accordingly, financial statement analysis that distinguishes the two types of liabilities informs on future profitability and aids in the evaluation of appropriate price-to-book ratios. Penman (1997) also argued that valuation involves forecasting payoffs and discounting expected payoffs for risk. He elaborated the idea that financial forecasting, risk determination, and valuation are a matter of accounting. Accounting not only provides information to forecast payoffs but also specifies the payoffs to be forecasted. J. McConnell & Servaes (1995), Lang et al. (1996) and Aivaziana et al. (2005) showed that financial leverage have a negative relation over firm's investment, which means that the ones with higher leverage often have lower investments. Titman & Wessles (1988) establishes that firms use their earnings instead of taking outside capital earn more profit because of less leverage as compare to the firms which rely more on outside capital which increase their leverage. It implies that debt magnifies the earnings available to shareholders. However, this assertion will only be valid if the return on assets (ROA) is higher than the cost of debt. In this case the more the debt, the higher the return on equity (ROE). The implication of this is that Earnings per Share and of course, Net Assets per Share will fall if the company obtains debt at a cost higher than the rate of return on the company's assets. Zahir & Khanna (1982) investigated the determinants of stock prices of 101 Industries in India for the year 1976-77 and 1977-78 and found dividend per share and yield to be a significant determinant of share price. Irfan & Nishat (2002) explained the stock price changes due to the six fundamental variables (dividend yield, payout ratio, and size of the firm, leverage, earnings volatility and asset growth). Nirmala, Sanju, & Ramachandran (2011) explained the impact of dividend, profitability, price earnings ratio and leverage on share prices in the context of the Indian Stock exchange.

IV. RESEARCH METHODOLOGY

This study is mainly quantitative in nature. For the purpose of the study, Quantitative data are collected and analyzed. Secondary data consisting of 30 samples were collected from the published annual report. For the purpose of analysis, we observe the data of annual report for the year 2008, 2010 and 2013. After collecting the data, these are analysed using Ms excel and SPSS. Simple analytical tools such as descriptive statistics, time series analytical tools have been applied

V. THEORETICAL FRAMEWORK

5.1 Leverage

The employment of asset or source of funds for which the firm has to pay fixed cost or fixed return is termed as leverage (Nissim & Penman, 2003). The asset or source of fund is act as force to boost up the firm's ability to increase the profitability. The higher leverage obviously implies higher outside borrowings and hence it is riskier if the firms earning capacity is reduced. In other words, only when the RNOA is higher than the cost of outside borrowing, the effect of leverage will be favorable.

Operating Leverage: Operating leverage is caused due to fixed operating expenses in a firm. It is the firm's ability to use fixed operating costs to magnify the effects of changes in sales on its earnings before interest and taxes. Operating leverage occurs at any time a firm has fixed costs that must be met regardless of volume.

Operating Liability Leverage (OLLEV) = Operating Liabilities/ Net Operating Assets (OL/NOA) (Nissim & Penman, 2003)

Financial Leverage: Financial Leverage (FLEV) is the measure of leverage from financing activities. It excludes operating liabilities but includes financial assets as a net against financing debt. If financial assets are greater than financial liabilities, FLEV is negative. FLEV is defined by following equation:

Financial Leverage (FLEV) = Net Financial Obligations / Common Shareholder's equity (NFO/CSE) (Nissim & Penman, 2003)

Combined Leverage: Operating and financial leverages together cause wide fluctuation in EPS for a given change in sales. It can be done by multiplying the operating leverage and financial leverage. The operating Leverage affects the EBIT and the financial leverage affects the EPS. The management has to devise a right combination of the operating and financial leverage. A company whose sales fluctuate widely and erratically should avoid use of high leverage since it will be exposed to a very high degree of risk (Nissim & Penman, 2003)

Net Borrowing Cost (NBC): Net Borrowing Cost (NBC) is derived from the expense incurred to manage debts for the organizations. NBC is defined by the following equation:

Net Borrowing Cost (NBC) = Net Financial Expense (NFE)/ Net Financial Obligations(Nissim & Penman, 2003).

Spread: In case of operating leverage, SPREAD comes from the difference between Return on Operating Assets and market borrowing rate. And in case of financial leverage, SPREAD comes from the difference between Return on Net Operating Assets (RNOA) and Net Borrowing Cost (NBC). Two types of SPREAD are expressed by following equations:

SPREAD 1 = RNOA – NBC (Nissim & Penman, 2003)

SPREAD 2 = ROOA - Market borrowing rate (Nissim & Penman, 2003)

5.2 Measures of Profitability

A company should earn profit to survive and grow over a long period of time. Profits are essential, but all management decision should not be profit centered at the expense of the concerns for customers, employees, suppliers or social consequences. Profit is the difference between revenues and expenses over a period of time (usually one year). Profit is the ultimate 'output' of a company, and it will have no future if it fails to make sufficient profits. The profitability ratios are calculated to measure the operating efficiency of the company. Some of the profitability ratios include the following:

Return on Capital Employed (ROCE): Return on Capital Employed (ROCE) is a weighted average of the return on operating activities and the return on financing activities. It is driven by the return on operations with an additional return from the leverage of financial activities. The ROCE can be calculated as follows:

ROCE = RNOA + FLEV * (RNOA – NBC)(Nissim & Penman, 2003)

Return on Net Operating Asset (RNOA): The Return on Net Operating Assets (RNOA) is defined as operating income divided by net operating assets. RNOA recognizes that profitability must be based on the net assets invested in the operations. RNOA is expressed by the following equation:

RNOA = Operating Income /Net Operating Assets ((OI/ NOA) (Nissim & Penman, 2003)

5.3 Measures of Equity Valuation

The Residual Earnings Valuation Model

There are many ratios that can be calculated from the financial statements and the equity analyst has to identify those that are important. The residual earnings equity valuation model brings focus to the task. The model can be applied to the valuation of any asset but the focus here is on the common equity. The model states the value of common equity at date 0 as

$V_0^E = CSE +$ Present value of future residual earnings, Where CSE is the book value of common equity. Residual earnings compare earnings to net assets employed and so is a measure of profitability. Residual earnings can be expressed in ratio form as:

$$RE = [ROCE_{t-1} - (pE - 1)] CSE_{t-1} \text{ (Penman, 1997)}$$

Where ROCE = CNI/CSE_{t-1} is the rate of return on common equity. So forecasting residual earnings involves forecasting ROCE and book values to be put in place to earn at the forecasted ROCE. We identify ROCE and CSE as the primary drivers of RE. Distinguishing ROCE and book value as two separate attributes to forecast helps to compartmentalize the task. But this is not to mean that ROCE and book values are independent. The amount of assets a firm will put in place might depend on ROCE and the accounting for book values may affect ROCE. Underconservative accounting, for example, ROCE is below its no-growth rate if investments are growing, and reducing investments generates higher ROCE, as modeled in (Zhang, 1998)

VI. FINDINGS AND INTERPRETATION

6.1 Leverage and performance of Banking Industry

Does leverage has any contribution to profitability? Leverage is driver for ROCE which is final indicator of profitability of a firm. If ROCE is decomposed than it will be found that $ROCE = RNOA + [FLEV * SPREAD]$ (Nissim & Penman, 2003)

Here ROCE is decomposed in two parts one is profitability of operating asset and other part is contribution from leverage and spread. $[FLEV * SPREAD]$ can be considered as the contribution of leverage to the profitability. Firms with high financial leverage have the risk of income volatility. Quality of earning is dependent on the leverage of the firm. Higher leverage creates risk and impairs the quality of the profitability

Table I: Descriptive statistics: All banks for the year 2010

	N	Minimum	Maximum	Mean	Std. Deviation
Flev	30	-11.3000	12.7900	8.1183330	4.6512780
Rnoa	30	-.1041	.1455	.076247	.0404315
Roce	30	-.1075	.7692	.342270	.1508146
NBC	30	.0185	.0883	.051353	.0148949
Spread1	30	-.1227	.0824	.024900	.0309401
ROA	30	-.0393	.1419	.077097	.0305102
Ollev	30	.0400	.5100	.104000	.0955781
Theta	30	.033937	.080600	.04951554	.008451717
Spread2	30	-.1199	.0791	.027579	.0322694
Valid N (list wise)	30	-	-	-	-

From the above table, we can see that the average return on equity for all the bank is 34.23% and average financial leverage for all the bank is 8.11, which is indicative of the impact of leverage on the performance. Maximum level of leverage afforded by banks is 12.79 and maximum return on equity earned by banks is 76.92%. On the other hand, minimum level of financial leverage afforded by banks is -11.3 whereas minimum level of return on equity is -1.075%. And average spread 1 for the entire bank is 0.0249 which is very healthy for growth of roce.

Table II: Descriptive statistics: All banks for the year 2012

	N	Minimum	Maximum	Mean	Std. Deviation
Flev	30	-2.0400	15.1200	7.6796670	2.8965193
Rnoa	30	-.0817	.0873	.057530	.0316106
Roce	30	.0288	.2589	.121973	.0568679
NBC	30	.0227	.0824	.053997	.0161890
Spread1	30	-.1084	.0213	.003527	.0218382
ROA	30	.0105	.0883	.061637	.0194685
Ollev	30	.0400	1.0000	.116000	.1706701
Theta	30	.024603	.128200	.06193002	.017389156
Spread2	30	-.1177	.0224	-.000283	.0243071
Valid N (list wise)	30	-	-	-	-

From the aforementioned table, we can figure out that the average return on equity for all the bank is 12.19% which is significantly lower than that of the previous year and average financial leverage for all the bank is 7.68. This phenomenon might be attributed to the presence of share price bubble in 2010. On top of that all the banks had an average spread of 0.003 which largely lower than the perhaps and perhaps the cause of slump in roce. Maximum level of leverage afforded by banks is 15.12 and maximum return on equity earned by banks is 25.89% which is lower than that of the previous year. On the other hand, minimum level of financial leverage afforded by banks is -2.04 whereas minimum level of return on equity is 2.8% which is higher than that of the previous year. This indicates that though the industry failed to earn higher roce, it succeeded to obtain steady and consistent earnings.

Table III: Descriptive statistics: All banks for the year 2013

	N	Minimum	Maximum	Mean	Std. Deviation
Flev	30	-1.7500	16.8400	8.4296670	3.2251196
Rnoa	30	-.0400	.0869	.056210	.0240088
Roce	30	.0272	.2025	.122573	.0460859
NBC	30	.0085	.0822	.051363	.0163196
Spread1	30	-.0679	.0175	.004847	.0145309
Roa	30	.0201	.0854	.057167	.0169109
Ollev	30	.0500	.9800	.118000	.1670102
theta	30	.005825	.077800	.03844449	.011736369
Spread2	30	-.0577	.0399	.018718	.0169023
Valid N (listwise)	30				

The aforementioned table suggests that the average return on equity for the entire bank is 12.25% which is lower than that of the previous year and average financial leverage for all the bank is 8.42. The average earnings had a standard deviation of 4.6% which is lower than that of previous year and it suggests that the earnings are more persistent across banks than the previous years. Average spread 1 is 0.004 which is higher than previous year but not significant enough. Maximum level of leverage afforded by banks is 16.84 and maximum return on equity earned by banks is 20.25% which is lower than that of the previous year. On the other hand, minimum level of financial leverage afforded by banks is -1.75 whereas minimum level of return on equity is 2.72%.

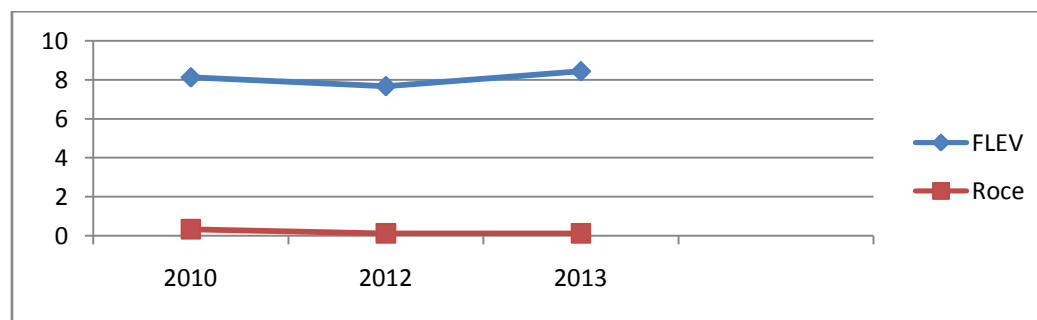


Figure I: Time series analysis for the year 2010, 2012 and 2013

To have a broader and overall view on the impact of leverage on performance, we can look at the line chart above. We can see the earnings are higher in the year 2010 with respect to the higher financial leverage. Roce went down a bit as the leverage went down in the year 2012. In 2010 a share price bubble took place which might have an impact on the earnings. But in the year 2013, we can see the earnings went down even though leverage increased sharply. This is due to the fact that the banks failed to earn enough spread between Rnoa and net borrowing cost.

6.2 Effect of leverage on Equity valuation

Operating liability leverage plays a very important role to lever the profitability of net operating asset. Measure of operating profitability is RNOA. RNOA can be decomposed as flows:
 $RNOA = ROA + OLLEV$ (Spread) (Nissim & Penman, 2003)

Operating leverage drives up the RNOA if there is positive spread between ROA and implicit cost of borrowing (theta) if any firm is highly levered than the second portion of the ROCE will be large. If there is any change in RNOA it will affect the spread and highly levered firms ROCE will be changed significantly. But on

the other hand firms with low leverage will not be affected significantly by the change in spread. Highly levered firm will experience more volatile income stream than a low levered firm. Bangladeshi banking industry recently experience some situation like above. In 2010 there is capital market boom in Bangladesh. It increased the RNOA of the banking industry thus the spread is increased. Banking industry is highly levered industry so all the bank experienced high profitability. The average ROCE of the banking industry in 2010 was 34.23%. But in 2011 the bubble has burst out and RNOA of the banking industry was decreased. And the central bank of the country adopted conservative monetary policy so NBC increased all these lower down the spread between RNOA and NBC. This results in a significant decrease of ROCE of the banking industry. In 2013 the average ROCE of banking industry was 12.25% in the next few pages; detailed discussion has been made on the equity valuation of listed banking companies.

Table IV: Data relating to 2010

Company	flev	ollev	Estimated price (p)	price(Market)	Comment
ABBANK	7.85	0.08	166.4531	141.3819	Lower
CITYBANK	8.2	0.13	74.26818	88.6714	Higher
IFIC	9.12	0.18	100.9431	139.1451	Higher
ISLAMIBANK	10.05	0.05	75.62553	67.24532	Lower
NBL	7.57	0.06	216.3165	131.6342	Lower
PUBALIBANK	7.79	0.11	90.53536	94.21683	Higher
RUPALIBANK	-11.3	0.33	217.4472	184.4209	Lower
UCBL	11.39	0.09	100.1848	202.6879	Higher
UTTARABANK	8.8	0.09	90.26897	144.4122	Higher
ICIBANK	-3.35	0.51	-27.43937	20.1825	Higher
EBL	5.64	0.06	119.9255	106.9675	Lower
ALARABANK	9.41	0.11	61.20745	67.4615	Higher
PRIMEBANK	8.14	0.06	88.05817	76.74351	Lower
SOUTHEASTB	7.91	0.04	58.01417	50.83515	Lower
DHAKABANK	10.25	0.15	84.30688	73.25525	Lower
NCCBANK	8.53	0.07	72.75289	63.32573	Lower
SIBL	7.01	0.07	28.60864	48.82458	Higher
DUTCHBANGLA	12.44	0.09	139.4382	210.9969	Higher
MTBL	10.64	0.07	61.13054	63.9302	Higher
STANBANKL	9.05	0.05	58.00785	54.56598	Lower
ONEBANKL	11.51	0.05	122.5647	94.49985	Lower
BANKASIA	10.48	0.12	86.74278	77.34349	Lower
MERCANBANK	12.1	0.08	50.59729	50.7033	Higher
EXIMBANK	9.41	0.04	71.197	66.83797	Lower
JAMUNABANK	9.19	0.06	70.18385	56.2531	Lower
BRACBANK	7.17	0.13	102.5063	80.80667	Lower
SHAHJABANK	8.42	0.04	80.38515	67.59032	Lower
PREMIERBANK	7.34	0.09	81.04258	63.99983	Lower
TRUSTBANK	10	0.04	78.23616	67.79893	Lower
FIRSTSBANK	12.79	0.07	26.27355	43.02424	Higher

In the above table, if the estimated share price exceeds market price it has been termed as “lower” and if the estimated share price falls short of market price it has been termed as “higher”. In the table we can see that City bank, IFIC, pubali bank, Ucbl, utara, ICI bank, Al arafa, SIBL, Dutchbangla, mercantile bank and firstsecurity bank has higher market price than estimated price which is indicative of the presence of share price bubble in 2010.

Table V: Data relating to 2012

Company	flev	ollev	Estimated price(P)	Price(market)	Comment
ABBANK	7.32	0.1	28.50402	33.78914	Higher
CITYBANK	4.19	0.13	10.02444	26.55172	Higher
IFIC	9.68	0.15	10.24814	35.75707	Higher
ISLAMIBANK	10.33	0.05	44.50001	41.76483	Lower
NBL	5.56	0.08	8.410115	22.99672	Higher
PUBALIBANK	6.46	0.13	18.80156	33.6731	Higher
RUPALIBANK	6.23	0.19	16.18053	83.78345	Higher
UCBL	7.36	0.1	17.41426	25.28397	Higher
UTTARABANK	6.96	0.11	29.86482	37.5819	Higher
ICIBANK	-2.04	1	-14.04638	7.902414	Higher
EBL	5.86	0.06	35.17167	32.13828	Lower
ALARABANK	5.77	0.09	24.19469	24.35431	Higher
PRIMEBANK	8.06	0.06	24.28005	33.2719	Higher
SOUTHEASTB	6.15	0.06	15.19378	19.36707	Higher
DHAKABANK	8.28	0.07	14.23176	23.93052	Higher

NCCBANK	6.89	0.06	17.07489	18.99172	Higher
SIBL	5.68	0.07	19.12623	19.67655	Higher
DUTCHBANGLA	9.25	0.11	99.82851	111.7957	Higher
MTBL	12.86	0.06	10.13338	22.72034	Higher
STANBANKL	8.2	0.06	31.0767	19.96259	Lower
ONEBANKL	8.05	0.06	23.83379	23.00534	Lower
BANKASIA	6.95	0.09	11.31035	22.08845	Higher
MERCANBANK	9.5	0.07	19.53535	19.32466	Lower
EXIMBANK	6.27	0.04	17.43186	20.60155	Higher
JAMUNABANK	8.97	0.05	21.58798	21.03948	Lower
BRACBANK	9.32	0.15	16.73567	33.77897	Higher
SHAHJABANK	9.28	0.08	27.83768	27.94448	Higher
PREMIERBANK	8.11	0.08	11.10179	16.63517	Higher
TRUSTBANK	9.77	0.05	6.971597	24.26724	Higher
FIRSTSBANK	15.12	0.07	18.91712	18.31879	Lower

In the table we can see that City bank, IFIC, pubali bank, Udbl, utara, ICI bank, Al arafa, SIBL, Dutchbangla, Mtbl has higher market price. Exim bank, NBL, Brac Bank, AB bank which previously had lower market price has experienced an increase in the market price.

Table VI: Data relating to 2013

company	flev	ollev	Estimated price(p)	Price(market)	Comment
ABBANK	7.61	0.11	30.563	26.2	Lower
CITYBANK	4.68	0.13	9.269277	20.2	Higher
IFIC	11.1	0.17	52.24255	34.3	Lower
ISLAMIBANK	8.94	0.06	47.21598	34.6	Lower
NBL	6.86	0.06	19.9306	11.8	Lower
PUBALIBANK	7.03	0.13	36.1834	32.5	Lower
RUPALIBANK	7.52	0.19	315.1089	65.2	Lower
UCBL	7.9	0.11	49.95212	25.1	Lower
UTTARABANK	9.56	0.1	48.7014	31.1	Lower
ICIBANK	-1.75	0.98	-12.35225	6.1	Higher
EBL	5.95	0.06	55.45485	29.1	Lower
ALARABANK	6.99	0.09	37.46186	19.1	Lower
PRIMEBANK	8.84	0.07	27.78051	25.9	Lower
SOUTHEASTB	7.31	0.06	52.18999	17.9	Lower
DHAKABANK	10.08	0.08	51.21298	18.8	Lower
NCCBANK	7.99	0.07	20.64462	13.1	Lower
SIBL	7.31	0.08	24.22381	13.3	Lower
DUTCHBANGLA	8.81	0.13	137.4511	104.7	Lower
MTBL	15.71	0.06	28.53736	16.3	Lower
STANBANKL	5.36	0.07	17.5863	14.8	Lower
ONEBANKL	8.48	0.06	36.70353	15.8	Lower
BANKASIA	7.97	0.11	26.73594	23	Lower
MERCANBANK	11.17	0.06	41.01764	16.7	Lower
EXIMBANK	6.6	0.05	24.36873	12.9	Lower
JAMUNABANK	10.28	0.05	34.04068	16.3	Lower
BRACBANK	10.82	0.15	40.93463	32.6	Lower
SHAHJABANK	9.36	0.07	26.89795	16.8	Lower
PREMIERBANK	8.22	0.06	21.34558	10.9	Lower
TRUSTBANK	9.35	0.05	11.79696	20	Higher
FIRSTSBANK	16.84	0.07	26.56431	15.1	Lower

In the above mentioned table, we can clearly see a collapse in the market price of most of the company's shares. There exist only 3 companies, city bank, ICI bank, which have market price that exceeds its estimated or intrinsic price.

VII. CONCLUSION

This study focused basically on the relationship pattern of leverages and stockholders returns that in turn affect the wealth maximization goal of a firm. The study has depicted leverage as the prime factor that should consider while objective of the firm i.e. wealth maximization is considered as important goal for the firm. So leverage is an indispensable factor for stockholders return. To conduct such study, relevant variables i.e. ROCE, RNOA, FLLEV, OLLEV, Rips, Nav have been measured. A sample of 30 banking companies has been used. Due to unavailability of information in the annual reports, this study may therefore lack in revealing complete forces of variables in earnings. This study reveals that leverage significantly affects stock holders return and thereby affect the valuation of equity. With the help of descriptive statistics this study has proved

there is a significance effect of leverage on EPS which supports the relevance theory of the capital structure. Movements in share price have also significant relationship with operating and financial leverage of a firm. Finally, it can be said that to get a clear view of a company and to focus on its capital structure and earnings information regarding such aspects should clearly be expressed in annual reports of the company. Otherwise it would be difficult for a researcher both to identify the critical factors which affect both capital structure and earnings of a firm and to give a helpful decision to the firm. A firm must also be careful about their financial decision. Every firm should have maintained a margin of leverage which affect earnings and share price positively. Thus a firm can maintain consistency in profitability.

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