

**UNITED INTERNATIONAL UNIVERSITY**

**Project Report**

 **on**

**THE EFFECT OF LEVERAGE ON PROFITABILITY OF THE TEXTILE COMPANIES IN BANGLADESH**

**Course Code: INT- 4399**

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**LETTER OF ACKNOWLEDGEMENT**

First of all, I would like to thanks almighty Allah for giving me the strength and composure to finish the task within the schedule time. I would also like to express my gratitude from the core of my heart to my mentor Mohammad Tariq Hasan, Assistant Professor, BBA program of United International University (UIU), who helped me in coordinating my entire report. His consistent support and cooperation showed the way toward the successful completion the report.

And finally, I like to say that I have tried hard to prepare this report accurately. However, there might be some errors and silly mistakes due to our aptitude and time constraint. In this regard, I seek your kind consideration and I am in the process of learning.

**LETTER OF TRANSMITTAL**

15th October, 2019

Mohammad Tariq Hasan

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Subject: Request for accepting the project report.

Dear Sir,

I would like to draw your kind attention that I am submitting my report about **“THE EFFECT OF LEVERAGE ON PROFITABILITY OF THE TEXTILE COMPANIES IN BANGLADESH**”. I have tried my level of best to prepare this report. I believe that all these ideas in this report will help me in future practical life.

It would be grateful for me if you kindly accept this paper. I tried my heart and soul to make this paper as perfectly. I would be very honored if this paper can serve its purpose.

Yours Obediently,

Md. Jasif

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**ABSTRACT**

The study examines the relationship between profitability and leverage of textile companies listed Dhaka stock exchange in Bangladesh. Literature review on the relationship between the firms’ profitability and leverage showed that there is either a positive, negative or neutral relationship between profitability and leverage. This study considers sample of 30 companies from 2013 to 2017 by using data from annual report of the companies listed on the Dhaka Stock Exchange. Degree of operating leverage has negative relationship with return on equity which implies increase in DOL causes decrease in return on equity which is similar to the study by Barker (1973), Selling &Stickney (1989). Degree of financial leverage has positive relationship with return on equity which implies that increase in financial leverage causes the increase in return on equity or decrease in degree of financial leverage also decrease return on equity. The relation is also found by Nimalathasan & Pratheepkanth (2012), Abid & Meseddi (2004). However, the results revealed a negative relationship between return on equity and total degree of financial leverage contrary to Nimalathasan & Pratheepkanth (2012), Abid & Meseddi (2004) study. Also found that degree of total leverage has a positive relationship between return on equity which implies increase in DTL can increase in profitability but within safety limits of the company.

**Key Words:** Profitability, Leverage, Textile industry, Bangladesh

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**CHAPTER ONE: INTRODUCTION**

The purpose of this study is to analyze the relationship between leverage and profitability of the companies listed in Dhaka Stock Exchange

**1.1. Back ground of the study**

Profitability has continually been a central term to see performance of companies, where an adequate level of profitability is important for a firm’s long-term survivability and success. Detailed examination of company’s profitability is of utmost importance to any stakeholders particularly to its common equity investors. When assets are being used to increase profit, operating decisions made by the manager can affect the profitability. The efficiency of creating profit by the company’s management from the assets essentially shows the efficiency of a firm. The analysis of leverage on profit of firms involves a substantial share of financial literature (Dean, 1968; Sheel, 1994). The significance of profitability as an index for evaluating business proficiency and debate encompassing the connection among leverage and profitability is the explanations for this. This study intends to look at the profit profile of textile firms in Bangladesh and to analyze the effect of leverage on profitability. Leverage is one of the tools used by firms to get their capital with a view to increasing profit. One of the common ways through which a company increases its profit is with the help of leverage. To increase the estimated level return on the company’s equity leverage uses debt instruments. But the risk of leverage becomes apparent as a company takes on an excessive amount of debt. On the off chance that a company assumes an excess of debt, it will be not able meet its installment prerequisites with its short- and long-term incomes. Likewise, as a company assumes more debt, the expense of obtaining more cash increments through higher financing costs. The stock cost or equity valuation of a company will be decreased dependent on the general danger of the company as it acquires more debt. It can increase the return on equity on short term but it in the long run increase risk. However, when it is utilized appropriately and inside safe limit, financial leverage can be valuable to a company. Using low financing costs, a company can fund-raise economically. From a long-term viewpoint, the proprietors will profit by having less value as the aftereffect of including different proprietors. The company must climate the additional expenses of debt to encounter the advantages of financial leverage. We as a whole realize that there is a connection among leverage and profitability. Also, here I attempt to discover those relations between the leverage of the companies and its profitability. We saw that those companies who has more leverage is superior to other companies. And furthermore, more leverage can impact on profitability. Essentially, this study will help to reveal that there is a significant relationship between leverage and profitability, and leverage basically helps to gear up the profitability of a firm and a textile firm is no exception.

**1.2. A brief introduction of textile industry and economic growth**

The textile industry is primarily concerned with the design, production and distribution of yarn, cloth and clothing. The raw material may be natural, or synthetic using products of the chemical industry. Textile industry inhabits an exceptional position in the Bangladesh economy. It is the biggest exporting industry in Bangladesh which experienced excellent development during last 20 years. The industry assumes a key role in increasing employment and in the provision of income to poor people. Almost two million laborers are legitimately, and in excess of ten million occupants are additionally in a roundabout way connected with the business. The sector also plays an important role in the socio-economic growth of the country. The total garments export contributed to GDP had been increased through the period from 1984 to 1985 to 2005 to 2006. The total garments exports are more than 68 times in 2005-2006 compared to the export in 1985-1985. The contribution of garments export reaches 12.64% of GDP in 2005-2006 whereas in 1994-1995 it was 5.87%. It is a clear sign of the overall contribution of the economy. It also plays a huge role in promoting the development of connecting small scale industries. For example, manufacturing of intermediate product such as dyeing, printing, zippers, labels have begun to take a position on limited scale and is predicated to grow significantly. Also, assisted the business of basling, insurance, shipping, hotel, tourism and transportation. It also created employment opportunities for about 2 million people of which 80% are females. However, a well-made strategy with varied product manufacture still offers more prospects to our economic development, and it can be developed by making wide range of diversification too. Nonetheless, the industry opened up jobs for many people by direct and indirect economic activities, which will ultimately help the country’s social progression, poverty alleviation and woman empowerment. Through this, Bangladesh is also getting favorable economic contribution from this industry. The textile industry is the single source of development in Bangladesh's fast-growing economy. Exports of textiles and garments are the main source of income in global market. 77% of total product export of Bangladesh was textile clothing and RMG by 2002. In 1972, the World Bank approximated the gross domestic product (GDP) of Bangladesh at US$6.29 billion, and it grew to $173.82 billion by 2014, with $31.2 billion of that generated by exports, 82% of which was RMG. As of 2016 Bangladesh held the 2nd place in producing garments just after China. Bangladesh is the world's second-largest attire exporter of western fashion brands. In the financial year 2016-2017 the RMG industry generated US$28.14 billion, which was 80.7% of the total export earnings in exports and 12.36% of the GDP; the industry was also taking on green manufacturing practices.

**1.3. The effect of leverage on profitability**

The effect of leverage on profitability can be both positive and negative. On the basis of leverage tools, it can differ the effect on profitability.

* It allows companies earn income from assets they normally cannot afford.
* It can increase the money they invest.
* If not leveraged within the safety limit it can increase the losses.
* It also increases losses if the assets value falls.

**1.4. Objective of the study**

In this study, 30 textile companies which are listed on Dhaka Stock Exchange (DSE) are taken for analysis. The main objective of this study is to analyze the relationship between leverage and profitability of textile companies operating in Bangladesh. What is the effect of leverage on profitability Specific objectives are:

I. To analyze the relationship between degree of operating leverage (DOL) and return on equity (ROE).

ii. To analyze the relationship between degree of financial leverage (DFL) and return on equity (ROE).

iii. To analyze the relationship between degree of total leverage (DTL) and return on equity (ROE).

**1.5. Rational of the Study**

Leverage amplifies investor profits or losses. It's most commonly used to describe the use of borrowed money to magnify profit potential. Leverage helps firm achieve their goal faster. It is to see whether, if higher leverage means more profit or lower leverage means more profit. It also measures if a firm uses its profit in the right place.

**CHAPTER TWO: LITERETURE REVIEW**

This includes some section. In the following literature review includes some section discussing theoretical approach, leverage and profitability proxy, the result of relationship of other study

**2.1. Trade-off Theory:** The trade-off theory claims that companies should aim to find the optimal level of financial leverage. With optimal level of financial leverage, it means when gains and costs of financial leverage is balanced (Myers, 1984). The advantages of financial leverage are according to the theory related to “tax advantage of debt” because of the deductibility of interest expenses, but also the increased cash flows (Modigliani and Miller, 1963; Kraus and Litzenberger, 1973). The tax advantage of debt indicates that larger companies measured by total assets should use more financial leverage than small companies, since they have more capital to “protect” (Ebaid, 2009). According to Kraus and Litzenberger (1973) could a disadvantage of financial leverage be the potential costs associated to bankruptcy. There are two types of cost that is associated to bankruptcy according to the trade-off theory. The direct cost refers to legal advice, credit cost and reconstruction, while costs like loss of employees is referred to as indirect costs in the trade-off theory (Murray and Vidhan, 2008; Brealey, Myers and Allen, 2017). According to the trade-off theory does the margin benefit of financial leverage decrease, unlike the disadvantages of the financial leverage-curve which constantly increases when the financial leverage increases. These factors could according to the trade-off theory be the reasons why it is more common that large companies use financial leverage than small companies (Brealey, Myers and Allen, 2017).

**2.2. Leverage and Profitability Proxy:**

Profitability used as dependent variable

* Return on assets
* Return on equity
* Net income
* Return on investment

Leverage used as independent variable

* Degree of operating leverage
* Degree of financial leverage
* Degree of total leverage
* Short term debt
* Long term debt
* Size
* Sales growth

**2.3. Prior Research**

The literature review focuses on relationship between leverage and profitability as the objective of this study is to determine if leverage is related to company’s profitability. The relationship between leverage and profitability has been the subject of considerable debate. Throughout the literature, debate has centered on whether there is any relationship between profitability and leverage. Many practical works on the relationship between profitability and leverage. Though, the discoveries of these studies are not the same. Some studies found positive relation between leverage and profitability while others found negative and inverse relation between leverage and profitability. There is also evidence of no relation between these two.

Robb and Robinson (2009) and Ruland and Zhou (2005) consider that there is a constructive relationship between leverage and profitability. Jensen (1986), Using more leverage increases firm’s profitability, which results in a positive relation between leverage and profitability. Moreover, this finding agrees with the study of Modigliani and Miller (1963). Chandra kumar mangalam and Govindasamy (2010) found that shareholders wealth is maximized when firms are able to employ more debt indicating leverage is positively related to profitability. Return on equity is increased or decreased by the use of high levels of debt in the capital structure. Peswani, Shilpa (2011) in her study has analyzed the impact of leverage on profitability of two best companies of FMCG sector i.e. Britannia Industries Ltd and Marico Industries. It was studied through analysis that Marico Industries Ltd was a high leveraged firm than Britannia Industries Ltd. A high leveraged firm was capable of providing high return on equity to its shareholders but the profitability of both the companies was similar. Camelia, Burja (2011) Using combined sources to fund activities and increase debt to a certain level that doesn’t affect the financial autonomy of the company is another way designed to increase the assets’ ability to generate profit. In the analyzed situation, action of the financial leverage was favorable and it acted in the sense of increasing the ROA, this aspect justifying the company’s financing strategy through increasing debts. Georgeta, Vintilla et al (2012), study found that having a high-level financial obligation has a positive significant influence on ROE. Many companies use debt to leverage capital. Khushbakht, Tayyaba (2013) study found that return on assets and degree of financial leverage have a positive relationship, whereas negative relation is found between return on assets and degree of operating leverage. And inverse relation between degree of financial leverage and return on investment also found inverse relationship between degree of operating leverage and return on investment. Also found positive relation between degree of financial leverage and earning per share and negative relation between degree of operating leverage and earning per share. The results show that the influence is not significant. So, degree of operating leverage and degree of financial leverage have no significant influence on return on equity, return on assets, return on investment and earning per share.

However, negative relation between leverage and profitability have been found in some studies. Study by Negash (2001) found negative impact of debt in company’s profitability, He said that the financial benefits generated from leverage are significant over an infinite period of time and which is supported by the Modigiliani and Miller (1963) theory. (Titman and Wessels, 1988) observed that highly profitable firms have lower levels of leverage than less profitable firms because they first use their earnings before seeking outside capital. In addition, stock prices reflect how the firm performs. Firms tend to issue equity rather than use debt when their stock price increases, so that their leverage levels stay lower than firms using debt. Similar findings were reported more recently in Gu (1993), Sheel (1994), Sunder & Myers (1999) and Wald (1999). According to Wald (1999), profitability, which is the most significant determinant of firms’ financial leverage, negatively affects the debt to assets ratios in the heteroskedastic tobit regression model. Sheel (1994) also supported the negative relationship between debt-to-assets ratio and non-debt tax shield or/and between firm’s leverage behavior and its past profitability. Debt does not consider tax benefits, Fama and French (1998). Negative relationships between leverage and profitability exist when leverage inclines to create problems between debt holders and shareholders. Few studies reported no or zero relationship between profitability and leverage. Long and Malitz (1986) found out that there is no relationship between capital structure and profitability. Due to inherited different characteristics of short-term and long-term debt, total debt as a whole has no association with firm profitability, Amjed (2007). Berkivitch and Israel (1996), think a company’s value, and debt amount is positively related if shareholders have complete authority over the company and inversely related when creditors can influence the development of the company. Therefore, there is a relationship between profitability and leverage. DFL has positive relationship with ROE which presents that increase in financial leverage cause the increase in return on equity or if degree of financial leverage decreases the return on equity also decreased. The relation is also found by Nimalathasan & Pratheepkanth (2012), Abid & Meseddi (2004). Degree of operating leverage have negative relation with return on equity which implies increased DOL causes decrease in return on equity. This relation is also pointed out by Barker (1973), Selling &Stickney (1989).

**CHAPTER THREE: METHODOLOGY OF THE STUDY**

**3.1. Data design:** This study made use of the secondary data of 30 textile companies listed in DSE obtained from company’s annual report. The data belong to the five-year period starting from 2013 to 2017 were taken in this study.

**3.2. Analytical tools:**

* Microsoft excel for calculating data and did using
* SPSS software for descriptive, correlation and regression analysis.

**3.3. Variable design:** One dependent variable made up of profitability ratios, three independent variables of leverage and two control variables is considered for this study

|  |  |  |
| --- | --- | --- |
| Dependent variables | Independent variables | Control variables |
| 1. Return on equity (ROE) | 1. Degree of Operating Leverage (DOL) | 1. Firm size (FSZ) |
|  | 2. Degree of Financial Leverage (DFL) | 2. Growth rate (GR) |
|  | 3. Degree of Combined Leverage (DTL) |  |

**3.3.1. Dependent variables:**

Return on equity (ROE): ROE is the relation of the company’s profitability to the equity. With this ratio we can see how well a company’s investment is used to generate We can measure how well a company uses investments to generate income. The formula is as follows:

Return on equity (ROE) = $\frac{Net Income}{Equity }$

In this study, profitability is used as dependent variable measured by net income to equity. It is an inclusive indicator of a company’s performance since it shown in percentage. Positive indicates managerial efficiency, and negative indicates managerial inefficiency.

**3.3.3. Independent variables:**

**DOL:** The Degree of operating leverage is the effect of certain amount of operating leverage has on a company’s EBIT over a period of time. Operating leverage is the use of a large portion of fixed cost in the company’s operation. The formula is as follows:

Degree of operating leverage (DOL) = $\frac{EBIT +operating fixed cost}{EBIT }$

Positive DOL: If operating leverage is positive it implies that a percentage change in sales increases net operating income in greater percentage when fixed cost has a greater share in the total cost structure of the company.

Negative DOL: If operating leverage is negative it implies that a decrease in percentage change in sales decreases net operating income in greater percentage when fixed cost has a greater share in the total cost structure of the company.

**DFL:** Degree of financial leverage is the relationship between percentage change in earning per share and percentage change in EBIT. In our study, DFL is independent in each year because it varies with the use of fixed financial cost the firms cost structure. Hence, the following formula can be derived as follows:

Degree of financial leverage (DFL) = $\frac{EBIT }{EBIT- Total Interest Expense }$

Positive DFL: if financial leverage is positive it implies that the acquired assets with the capital given by the preferred stockholders and creditors create a rate of return that is higher than the rate of interest or divined payable. Therefore, use of financial leverage may increase the profitability of common stockholders.

Negative DFL: if financial leverage is negative it implies that the acquired assets with capital given by preferred stockholder and creditor creates a rate of return less than the rate of interest or divined payable. Therefore, if financial leverage is negative it reduces the profitability of common stockholder.

 **Degree of combined leverage (DTL):**

With a certain change in sales the combined effect of the DOL and the DFL has on EPS is summarized in this leverage ratio. With this ratio the ideal level of operating and financial leverage to use can be determined. The formula is as follows:

Degree of total leverage (DTL) = DOL\*DFL

**3.3.4. Control variables:**

 Firm size: Firm size shows how big a firm is. It can be measured by the natural logarithm of total assets. It shows the relationship between firm size and profitability. If it is a large firm profit of the firm will be higher.

 Growth Rate: Growth rate is the rate at which a firm’s sales is measured to see if the firm sales increases or decreases

Growth Rate = $\frac{Y2-Y1}{Y1}$

**3.4. Model specification:**

Model**:** ROE= a + β1DOLit + β2DFLit+ β3DTLit+ β4FSZit+ β5GRit +εit

Here,

Return on Equity = ROE Firm size = FSZ

Degree of operating leverage = DOL Growth rate: GR

Degree of financial leverage = DFL i = Company position

 Degree of total leverage = DFL t = period

ēi,t = Random error term

**3.5. Hypothesis development:**

Degree of operating leverage has negative relationship with return on equity which implies increase in DOL causes decrease in return on equity. This relation is also pointed out by Barker (1973), Selling &Stickney (1989).

**Hypothesis-1:** **DOL has negative relation with ROE.**

Degree of financial leverage has positive relationship with return on equity which presents that increase in financial leverage cause the increase in return on equity or if DFL decreases the ROE also decreased. The relation is also found by Nimalathasan & Pratheepkanth (2012), Abid & Meseddi (2004)

 **Hypothesis-2: DFL has positive relation with ROE.**

Jensen (1986), Using more leverage increases firm’s profitability, which results in a positive relation between leverage and profitability. Moreover, this finding agrees with the study of Modigliani and Miller (1963).

**Hypothesis-3: DTL has positive relation with ROE.**

**CHAPTER FOUR****: FINDINGS AND ANALYSIS**

Return on equity = ROE, Degree of operating leverage = DOL, Degree of financial leverage = DFL, Degree of total leverage = DTL, Growth rate = GR, Firm size = FSZ

**4.1. Descriptive analysis**:

Table: 4.1 Descriptive statistics

|  |
| --- |
| **Descriptive Statistics** |
| Variable | observation | Minimum | Maximum | Mean | Std. Deviation |
| ROE | 150 | -.155899 | .942171 | .08275534 | .100150398 |
| DOL | 150 | -4.948184 | 12.349722 | 2.13537359 | 2.000851370 |
| DFL | 150 | -27.902778 | 50.336149 | 1.62664103 | 4.975553731 |
| DTL | 150 | -135.846939 | 60.557352 | 1.15683469 | 16.568770613 |
| GR | 150 | 18.993478 | 24.907172 | 21.53175125 | 1.010273765 |
| FSZ | 150 | -.668802 | 10.531956 | .13793243 | .891017011 |

The table 4.1 shows the descriptive statistic of analysis of this study.

The dependent variable is ROE which average is .082755.

The independent variable is DOL which is 2.135373, DFL which is 1.626641 and DTL which is 1.156834.

 The control variable GR which is 21.531751 and FSZ which is .13793243.

**4.2. Correlation analysis:**

Table: 4.2 Correlation of the variable

|  |
| --- |
| **Correlations** |
| Variable | ROE | DOL | DFL | DTL | GR | FSZ |
| ROEDOLDFLDTLGRFSZ | 1 |  |  |  |  |  |
| -.035 | 1 |  |  |  |  |
| .028 | -.234\*\* | 1 |  |  |  |
| .108 | -.320\*\* | .720\*\* | 1 |  |  |
| -.260\*\* | -.189\* | .019 | .005 | 1 |  |
| .139 | -.052 | .032 | .029 | -.028 | 1 |
| \*\*. Correlation is significant at the 0.01 level (2-tailed). |
| \*. Correlation is significant at the 0.05 level (2-tailed).  |

The table 4.2 shows the correlation analysis of 150 observation from period 2013 to 2017.

The correlation maybe positive or negative. DOL is negatively related with ROE. DFL is positively related with ROE and significantly related with DOL. DTL is positively related with ROE and significantly related DOL and DFL. GR is negatively related with ROE, DOL and is related significantly and positively related with DFL, DTL. FSZ is positively related with ROE, DFL, DTL and negatively related with DOL, GR.

**4.3. Regression analysis:**

To analyze the relationship between leverage and profitability, regression analysis was made. ROI measures the profitability which is regressed against DOL, DFL, and DTL. Table 4.3 shows the results of regression analysis It ought to be noticed that the estimations of all the variables are at 5% significant level. The table clarifies the quantity of variability in dependent variable explained by independent variable. The R2 is 0.103 that implies approx. 10.3% of the variability of dependent variable (ROE) is clarified by the independent variables and remaining of the variance is unexplained. Adjusted R2 is 7.2% indicating that 7.2% variability in dependent variable can be explained by independent variables.

The value of Durbin-Watson always lies between 0 and 4. If the Durbin-Watson statistic is substantially <2, there is evidence of positive serial correlation. As a rough rule of thumb, if Durbin Watson is <1, there may be cause for alarm. In our study, the value of Durbin-Watson test is 1.698 which indicates that there is no serious statistical problem. Since the textile industry is very fast-growing industry in Bangladesh. Most of the companies are inclined to use the high degree of leverage. Since the mean value of DOL is 2.1353735 and DFL is 1.6266410.

Table: 4.3 Model summary

|  |
| --- |
| **Model Summary** |
| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | Durbin-Watson |
| R Square Change | F Change | df1 | df2 | Sig. F Change |
| 1 | .321a | .103 | .072 | .096489800 | .103 | 3.304 | 5 | 144 | .007 | 1.698 |
| a. Predictors: (Constant), Size, Growth, DTL, DOL, DFL |
| b. Dependent Variable: ROE |

Table: 4.4 Coefficients of the variable

|  |
| --- |
| **Coefficients** |
| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta |
| 1 | (Constant) | .654 | .174 |  | 3.751 | .000 |
| DOL | -.003 | .004 | -.050 | -.593 | .554 |
| DFL | -.002 | .002 | -.099 | -.873 | .384 |
| DTL | .001 | .001 | .161 | 1.378 | .170 |
| Growth | -.026 | .008 | -.265 | -3.287 | .001 |
| Size | .014 | .009 | .127 | 1.605 | .111 |
| a. Dependent Variable: ROE |

• Here, β1 is the slope of DOL, β2 is the slope of DFL, and β3 is the slope of DTL. If DFL, DOL, and DTL are zero, then a = ROE.

• Here, ROE = .654 which is Y intercept. It shows that ROE is positive indicating without the independent variables there will be no ROE of the textile industry of Bangladesh.

• Now, the value of β1 or the slope of DOL is −.003. It means if the DOL increases by 1% then the ROE of textile industry decreases by 0.3% assuming all other variables are constant.

 • Next, the value of β2 or the slope of DFL is −0.002. It means if DFL increases by 1% ROE decreases by 0.2% and vice versa assuming all other things are remaining same.

• Moreover, finally, the value of β3 or the slope of DTL is 0.001. It means if DTL increases by 1% ROE also increases by 0.1% and vice versa assuming all other things are remaining same.

The main emphasis of our study is to scrutinize the effect of leverage on profitability of textile sector by ROE and DOL, DFL, DTL.

DOL has a negative relationship with ROE. So as per the results the hypothesis can be accepted. There we saw that ROE and DOL relation is negative.

DFL has a positive relationship with ROE. So as per the results the hypothesis cannot be accepted. There we saw that ROE and DOL relation is negative.

DTL has a positive relationship with ROE. So as per the results the hypothesis can be accepted. There we saw that ROE and DOL relation is positive.

**CHAPTER FIVE: CONCLUTION AND RECOMMENDATION**

This research is conducted on the textile industry of Bangladesh from 2013 to 2017 to investigate the effect of leverages on profitability. Three hypotheses are built to find the effect of leverages on profitability. The results of hypothesis 1 indicate that operating leverage have negative relation with return on equity which is a measure of profitability. Degree of operating leverage has negative relation with return on equity because textile sector of Bangladesh is highly operating leveraged means a large number of fixed operating costs are required to run its operation, so degree of operating leverage has negative relation with profitability. Also, degree of operating leverage shows negative relation with return on equity because increase in operating leverage causes the increase in operating fixed cost. To balance the fixed cost more sales are required for organization. This shows the companies are not utilizing their equity efficiently to bear the cost of finance and other operating fixed costs to convert the amount of loan into more constructive way. The negative relation between operating leverage and profitability also identified by Barker (1973), Selling and Stickney (1989). In the same way hypothesis 2 analysis shows that degree of financial leverage has negative relation with return on equity. But the study by Yoon & Jang (2005) identifies the positive relation between degree of financial leverage and return on equity may occur due to finance cost provide shield from tax which cause the decrease in cost of capital. The hypothesis 3 shows a positive relation which can mean using DOL and DFL at a safe limit can increase companies’ profitability.

This study shows leverages have very sensitive relationship with profitability. Companies should adopt measures to reduce the operating cost because sales are not increasing with proportion of the operating cost. Companies should also manage the finance cost for getting optimal benefits from the loans.

**CHAPTER SIX: APPENDIX**

**6.1. REFRENCES**

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**6.2. List of textile companies:**

1. Al-Haj Textile Mills Limited
2. Alltex Industries Ltd.
3. Anlimayarn Deying Ltd.
4. Apex Spinning & Knitting Mills Limited
5. Desh Garmants Ltd.
6. Envoy Textiles Limited
7. Generation Next Fashions Limited
8. Hamid Fabrics Limited
9. H.R.Textile Ltd.
10. Maksons Spinning Mills Limited
11. Malek Spinning Mills Ltd.
12. Matin Spinning Mills Ltd.
13. Metro Spinning Ltd.
14. Mozaffar Hossain Spinning Mills Ltd.
15. Nurani Dyeing & Sweater Limited
16. Pacific Denims Limited
17. Paramount Textile Limited
18. Rahim Textile Mills Ltd.
19. Regent Textile Mills Limited
20. Safko Spinnings Mills Ltd.
21. Saiham Cotton Mills Limited
22. Saiham Textile Mills Ltd.
23. Shasha Denims Limited
24. Simtex Industries Limited
25. Sonargaon Textiles Ltd.
26. Square Textile Ltd.
27. Stylecraft Limited
28. Tosrifa Industries Limited
29. Zaheen Spinning Limited
30. Zahintex Industries Limited