Leverage:

Operating leverage is a measure of Business Risk involved and Financial leverage is a measure of Financial risk involved. Business risk is defined as how Earnings before interest and tax (EBIT) varies and Financial risk is defined as how Earnings before tax (EBT) varies. While the business risk is result of both internal and external factors, Financial risk arises because of use of financial leverage.While Business risk is independent of different forms of financing, Financial risk is a function of different forms of financing.

A. Operating Leverage

1. Degree of Operating Leverage (DOL) = $\dfrac{\text{Percentage of change in EBIT}}{\text{Percentage of change in Sales}}$

2. Degree of Operating leverage (DFL) = $\dfrac{\text{Contribution}}{\text{EBIT}} = \dfrac{\text{Sales -- Variable Costs}}{\text{Sales --Var Costs -- Fixed costs.}}$

Financial leverage

3. Degree of Fin Leverage (DFL) = $\dfrac{\text{Percentage of change in EPS}}{\text{Percentage of change in EBIT}}$

Degree of Fin Leverage (if there is no pref dividend) = $\dfrac{\text{EBIT}}{\text{EBT}}$

Degree of Fin Leverage (If there is pref dividend) = $\dfrac{\text{EBIT}}{\text{EBT} - \dfrac{\text{(PREF DIVIDEND)}}{(1 - \text{tax})}}$

Combined Leverage

4. Degree of Combined Leverage (DCL) = DOL x DFL
5. Degree of Combined Leverage (if no pref dividend) = $\dfrac{\text{Contribution}}{\text{EBT}}$

6. Degree of Combined Leverage (if there is pref divined) =

$$\frac{\text{Contribution}}{\dfrac{\text{EBT} - \text{Pref dividend}}{(1-t)}}$$

Sriniwaas,**M.Sc, CMA, PGDCA,**

NALLAKUNTA, HYDERABAD-44
EMAIL:cabrilliants@gmail.com
cell:7893621068
www.cabrilliants.comule.com