CHAPTER 6

Leverages

MULTIPLE CHOICE QUESTIONS

1. Given

Operating fixed costs	₹20,000
Sales	₹1,00,000
P/V ratio	40%

The operating leverage is:

(*a*) 2.00 (*b*) 2.50

(*c*) 2.67 (*d*) 2.47

2. If EBIT is ₹15,00,000, interest is ₹2,50,000, corporate tax is 40%, degree of financial leverage is:

(*a*) 1.11 (*b*) 1.20

(*c*) 1.31 (*d*) 1.41

3. If DOL is 1.24 and DFL is 1.00, DCL would be:

(*a*) 2.14 (*b*) 2.18

(*c*) 2.31 (*d*) 2.47

4. Operating leverage is calculated is calculated as:

(*a*) Contribution ÷ EBIT (*b*) EBIT ÷ PBT

(*c*) EBIT ÷ Interest (*d*) EBIT ÷ Tax

5. Financial leverage is calculated as:

(*a*) EBIT ÷ Contribution (*b*) EBIT ÷ PBT

(*c*) EBIT ÷ Sales (*d*) EBIT ÷ Variable cost

6. Which of the following is correct?

(*a*) CL = OL + FL (*b*) CL = OL – FL

(*c*) CL = OL × FL (*d*) CL = OL ÷ FL

7. Which of the following indicates business risk?

(*a*) Operating leverage (*b*) Financial leverage

(*c*) Combined leverage (*d*) Total leverage

8. Degree of combined leverage is the fraction of:

(*a*) Percentage change in EBIT on Percentage change in Sales

(*b*) Percentage change in EPS on Percentage change in Sales

(*c*) Percentage change in Sales on Percentage change in EPS

(*d*) Percentage change in EPS on Percentage change in EBIT

9. From the following information, calculate combined leverage:

Sales	₹20,00,000
Variable cost	40%
Fixed cost	₹10,00,000
Borrowings	₹10,00,000 @ 8% p.a.

(*a*) 10 times (*b*) 6 times

(*c*) 1.667 times (*d*) 0.10 times

10. Operating leverage is a function of which of the following factors?

(*a*) Amount of variable cost (*b*) Variable contribution margin

(*c*) Volume of purchases (*d*) Amount of semi-variable cost

11. Financial leverage may be defined as:

(*a*) Use of funds with a product cost in order to increase earnings per share

(*b*) Use of funds with a contribution cost in order to increase earnings before interest and taxes

(*c*) Use of funds with a fixed cost in order to increase earnings per share

(*d*) Use of funds with a fixed cost in order to increase earnings before interest and taxes

12. If Margin of Safety is 0.25 and there is 8% increase in output, then EBIT will be:

(*a*) Decrease by 2% (*b*) Increase by 32%

(*c*) Increase by 2% (*d*) Decrease by 32%

13. If degree of financial leverage is 3 and there is 15% increase in Earning per share (EPS), then EBIT will be:

(*a*) Decrease by 15% (*b*) Increase by 45%

(*c*) Decrease by 45% (*d*) Increase by 5%

14. When EBIT is much higher than Financial break-even point, then degree of financial leverage will be slightly:

(*a*) Less than 1 (*b*) Equals to 1

(*c*) More than 1 (*d*) Equals to 0

15. Firm with high operating leverage will have:

(*a*) Higher breakeven point (*b*) lower business risk

(*c*) Higher margin of safety (*d*) All of above

16. When sales are at breakeven point, the degree of operating leverage will be:

(*a*) Zero (*b*) Infinite

(*c*) One (*d*) None of above

17. If degree of combined leverage is 3 and margin of safety is 0.50, then degree of financial leverage is:

(*a*) 6.00 (*b*) 3.00

(*c*) 0.50 (*d*) 1.50

18. Operating leverage helps in analysis of:

(*a*) Business Risk (*b*) Financing Risk

(*c*) Production Risk (*d*) Credit Risk

19. Which of the following is studied with the help of financial leverage?

(*a*) Marketing Risk (*b*) Interest Rate Risk

(*c*) Foreign Exchange Risk (*d*) Financing risk

20. High degree of financial leverage means:

(*a*) High debt proportion (*b*) Lower debt proportion

(*c*) Equal debt and equity (*d*) No debt

21. Which combination is generally good for firms:

(*a*) High OL, High FL (*b*) Low OL, Low FL

(*c*) Low OL, High FL (*d*) High OL, Low FL

22. FL is zero if:

(*a*) EBIT = Interest (*b*) EBIT = Zero

(*c*) EBIT = Fixed Cost (*d*) EBIT = Pref. Dividend

23. Use of Preference Share Capital in Capital structure:

(*a*) Increases OL (*b*) Increases FL

(*c*) Decreases OL (*d*) Decreases FL

24. Operating leverage works when:

(*a*) Sales Increases (*b*) Sales Decreases

(*c*) Both (*a*) and (*b*) (*d*) None of (*a*) and (*b*)

25. If the fixed cost of production is zero, which one of the following is correct?

(*a*) OL is zero (*b*) FL is zero

(*c*) CL is zero (*d*) None of the above

26. If a firm has no debt, which one is correct?

(*a*) OL is one (*b*) FL is one

(*c*) OL is zero (*d*) FL is zero

27. Financial leverage is also known as:

(*a*) Trading on equity
(*b*) Trading on debt
(*c*) Interest on equity
(*d*) Interest on debt

28. The probability of bankruptcy is higher

(*a*) for a levered firm
(*b*) for an unlevered firm
(*c*) Both (*a*) & (*b*)
(*d*) None of the above

29. Operating leverage examines_____

(*a*) The effect of the change in the quantity on EBIT
(*b*) The effect of the change in EBIT on the EPS of the company
(*c*) The effect of the change in output to the EPS of the company
(*d*) The effect of change in EPS on the output of the company

30. A firm has a DOL of 4.5 at Q units. What does this tell us about the firm?

(*a*) If sales rise by 4.5%, then EBIT will rise by 1%
(*b*) If EBIT rises by 4.5%, then EPS will rise by 1%
(*c*) If EBIT rises by 1%, then EPS will rise by 4.5%
(*d*) If sales rise by 1%, then EBIT will rise by 4.5%

31. If the Return on Investment (ROI) exceeds the rate of interest on debt, it is _____financial leverage.

(*a*) unfavorable
(*b*) adverse
(*c*) favorable
(*d*) negative

32. If there is a 10% increase in sale, EBIT increase by 35% and if sales increase by 6%, taxable income will increase by 24%. Operating leverage must be -

(*a*) 1.15
(*b*) 3.50
(*c*) 4.00
(*d*) 2.67

Answer Key

1. (*a*)	**2.** (*b*)	**3.** (*d*)	**4.** (*a*)	**5.** (*b*)	**6.** (*c*)	**7.** (*a*)	**8.** (*b*)	**9.** (*a*)	**10.** (*b*)
11. (*c*)	**12.** (*b*)	**13.** (*d*)	**14.** (*c*)	**15.** (*a*)	**16.** (*b*)	**17.** (*d*)	**18.** (*a*)	**19.** (*d*)	**20.** (*a*)
21. (*c*)	**22.** (*b*)	**23.** (*b*)	**24.** (*c*)	**25.** (*d*)	**26.** (*b*)	**27.** (*a*)	**28.** (*a*)	**29.** (*a*)	**30.** (*d*)
31. (*c*)	**32.** (*b*)								