

Assignment - 12

Why does EBIT fall as the firm takes more debt?

Increased Interest Expense higher debt levels lead to higher interest payments reducing EBIT

Higher default risk

Excessive debt increase default risk reducing investors confidence

potentially lowering sales / Revenue

Reduced operating efficiency: Debt

serving costs diverting resource from

operation & potentially decreasing operational efficiency

Increased financial distress cost
Higher debt increases financial

distress risk

moderate debt level can provide
tax benefit increasing EBIT

Debt can discipline management to
optimise operation