



**THE EFFECTS OF FINANCIAL LEVERAGE ON THE BANKING PERFORMANCE
OF UK**

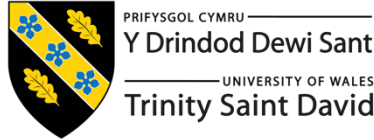
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Abstract

The aim of the study was to analyse effects of financial leverage on the financial performance and liquidity position of Banks in United Kingdom. For this purpose, data of 10 years for five banks were collected from Thomson Reuters and correlation and multiple regression technique was applied to address the research questions. Meanwhile, the empirical investigations in chapter reveals that debt to equity and debt to assets ratio have statistically insignificant relation with EPS, ROE, NPM and current ratio; but loan to deposit ratio has negative relation with EPS and positive relation with current ratio significantly. Furthermore, EPS of the banks is negatively affected by debt to assets and loan to deposits ratio and positively by debt to equity; whereas second model reveals that only debt to assets and loan to deposits have negative and significant effect on ROE. In addition to, NPM is not affected by the financial leverage of the banks; whereas last model reveals that debt to assets ratio negatively affect liquidity position of banks and that debt to equity positively affects liquidity. Based on the findings of the empirical investigation, the study also provides practically implications for the management and decision makers.

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CHAPTER 1: INTRODUCTION

1.1 Introduction

Within this contemporary business world, it has been observed that there is a growing interest of dwindling movement in the economic trends that are not just in the UK but has spread over different locations around the world. There are different sources of funding that are observed by businesses such as the owner's funding and the borrowed finding (debt). According to Jouida and Hellara (2018), the financial leverage is referred to as the utilisation of financial debt in the organisation rather than using fresh equity to meet the requirements of the business. The following research is aimed to assess the impact of financial leverage within the banking industry of the UK. The research conducted by Towo, Mori, and Ishengoma (2019) has claimed that the use of debt is necessary for the industry, however, it creates the increasing liabilities on the business that may not be effective for the long-term profitability. According to the assessment of Lee et al (2017), the accurate combination of debt and equity is considered to be the most effective element of financial planning in the organisation. Leverage is referred to as the borrowed money or the funds that are taken for investment. Gatsi, Gadzo, and Oduro (2016) has also added that the use of debt and the capital increases the total earning of the organisation if the return of investment exceeds the cost of financing in return.

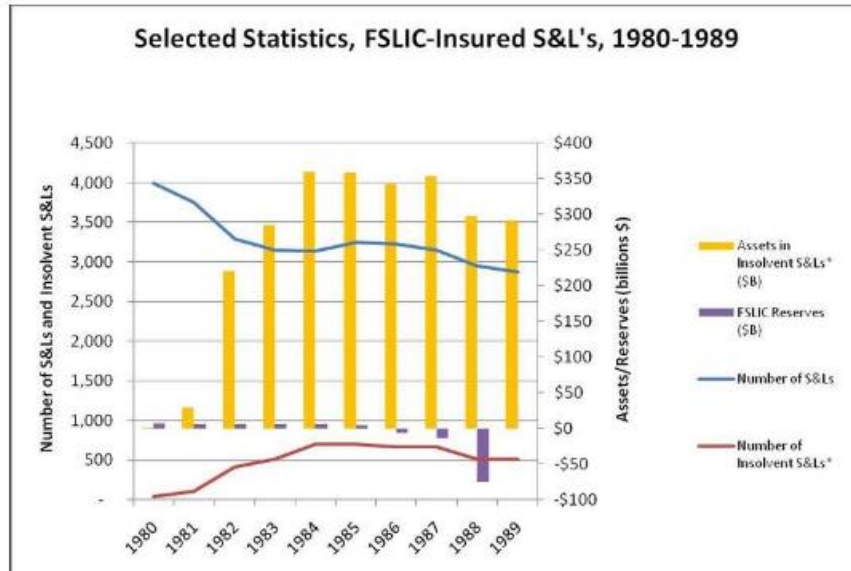
Based on the arguments of Das (2017), it is effective for the organisations to take investment decisions in the organisation that is the combination of the debt and equity for the development of an accurate capital structure. Similarly, another study conducted by Thi Bich Ngoc, Ichihashi and Kakinaka (2019) has also argued that the financial experts have been investigating the issues of a firm's financial performance using the theoretical approaches. The researchers have also investigated the relationship between the leverage and financial performance

of the firms in this regard (Afolabi et al., 2019), (Schoen, 2017). Moreover, the study conducted by Chechet and Olayiwola (2014) has also investigated the combination of the financial and non-financial organisations that has different methods of investment. However, the investment methods of both of these institutions are different in this regard. Based on the investigation of the financial sector of the UK, it has been observed that within the year 2018, the financial service sector in the UK has contributed nearly £132 billion to the UK economy Mohamed (2016).

1.2 Research Background

The concept of financial leverage has been observed in the year 1933 according to Lin, Schmid, and Xuan (2018). The financial leverage is referred to the debt taken by the organisations to maximise their assets and increase the return on equity. According to the analysis of Sodeyfi (2016), the organisations have been using the system of financial leverage for a long time and has been gaining benefits by increasing their profitability. This aspect is being used by the organisations and has been providing different benefits in this regard.

According to Anagnostopoulou and Tsekrekos (2017), some of the major examples of the financial debt crisis can be observed in Latin America. The country has faced a severe issue of the debt crisis in the year 1980 that was not the result of the corporations but was the debt by the sovereign governments. The heavy borrow has resulted in having an insignificant response from the financial institution and the country faced severe losses. Additionally, the US saving and loan crisis is also under consideration and can be used as an example for understanding the issues of financial crisis due to the presence of these loans.



Moreover, the Asian debt crisis can also be considered for assessing the aspect of financial leverage. This crisis was put forward in the year 1990s and had severe consequences in this regard. According to the arguments of Afolabi et al (2019), financial institutions undergo the process of investment that is comprised of the combination of debt and equity to gain profitability. Additionally, it has also been assessed that the use of financial leverage is common within the banks for carrying out investment in different areas and gaining higher returns. Moreover, it has also been common for the non-financial institutions that can be effective for gaining favourable returns and having certain benefits for the short term and long-term investment. Adenugba, Ige, and Kesinro (2016) have argued that if the firms are unable to repay the debt, they also may reach to the bankruptcy and can also face severe issues in terms of credibility and reliability of the consumers. According to Bhardwaj (2018), the debt ratio and equity ratio is also assessed by the investors while carrying out the activities for accurate investment.

1.3 Problem Statement

One of the most important decisions made by financial institutions is to make financial plans for investment. According to the arguments of Woods, Tan, and Faff (2019) the most effective financial plan is comprised of the proper ratio of debt and equity that is required for investment. However, it is highly difficult for organisations to undertake the operations that are comprised of debt and equity. Hussein and AL-Musawi (2017) have argued that the constant struggle of managing long term financing also leads towards the maximisation of shareholders' wealth. The aspect of debt and equity ratio has gained much attention from the researchers such as Harjoto (2017) and Russell Briggeman and Featherstone (2017) who have investigated the situation faced by the organisations as a result of having debt. Moreover, Sari and Wiksuana (2018) have also argued that the increasing debt of the company also affects its liquidity at a higher rate. Several studies have been carried out on the topic of debt and equity ratio but the financial institutions are still not aware of the most suitable methods to be used for their long term and short term investment.

According to the arguments of Ali et al. (2019), the increasing debt of the company is also very risky for the organisations as it limits the opportunities for growth and the overall revenue generated by the organisation. Despite having several benefits, debt financing and financial leverage have different drawbacks that are generally faced by the organisations in this regard. Therefore, the problem that is under consideration in the following study is to investigate the impact that is there on the financial institutions as a result of the debt and financial leverage used by the organisations. According to the arguments of Xinyuan, Nan, and Yufei (2017), the increasing debt of the organisations may also lead towards the obligation of having more payback

and also having penalties if the company fails to pay the debt on time. Therefore, it has been observed that the organisations face several issues due to the reason of having debts.

1.4 Research Aim and Objectives

The core aim of the study is to investigate the effects of the financial leverage possessed by financial institutions. The researcher has aimed to assess the potential impact of the financial leverage on these financial institutions. The study has been designed for the financial sector of the UK. It has been assessed that the researcher has aimed to investigate the practical assumptions and outcomes of the financial sector concerning the factor of financial leverage. The objectives of the study have been provided as under;

- To study the concept and significance of financial leverage.
- To identify the determinants of financial leverage and financial performance of an organisation
- To evaluate the impact of financial leverage on banking performance of firms for UK banking companies
- To provide recommendations and implications for improvisation of banking performance through effective management of financial leverage to the banking sector of UK.

1.5 Research Questions

The research has answered the following question within the following research;

“How the production of banking companies is influenced by financial leverage?”

However, the research questions to be answered in the following study are provided as under;

- What is the concept and significance of financial leverage in the context of financial performance?
- What factors measure the financial leverage and financial performance of an organisation?
- What is the impact of financial leverage on the performance of banking companies in UK?
- What are the recommendations on the improvisation of banking performance through financial leverage in the UK?

1.6 Significance and Rationale of the Study

The following study has made contributions to the financial sector in the UK as well as other countries that are depending on the financial sector. According to the study of Dey, Hossain, and Rezaee (2018), the financial and non-financial organisations look forward to adopting the most feasible method of investment in the organisation that is combined with the accurate ratio of debt and equity. However, different issues and concerns are faced by the organisations towards this method of investment. The study has also facilitated the investors and the financial decision-makers of the organisation to invest in favour of the organisation. The study of Pinto and Joseph (2017) has argued that the limited research on the impact of financial leverage has created the hurdles towards investment decisions as they are not aware of the outcomes. Therefore, the following study has contributed to the financial institution of UK and also has provided benefits to the financial intuitions of other countries for taking investment decisions towards financial leverage.

The limited research on the topic of impact of financial leverage on the organisations has led to the discovery of different issues regarding the financial outcomes and the investment

decisions. According to Sodeyfi (2016), the organisations look for the methods that can bring about profitable changes in the company and can also provide higher return on investment. However, the methods of investment are also based on debt-equity and the financial leverage that can be opted by the organisations for investment purposes. The financial and non-financial organisations seek the method of financial leverage to carry out the short term and long term investment according to the analysis of Abubakar (2016).

1.7 Structure of the Study

The study has been designed to investigate the impact of financial leverage on financial institutions in the UK. The study has been divided into different sections that have been segregated accordingly.

- The first chapter has provided with the background and introduction of the study and has set the stage for the objectives to be achieved.
- The second chapter has outlined the reviews and arguments of different authors by presenting the review of the literature. This chapter has also highlighted the conceptual and theoretical framework for investigation.
- The third chapter has highlighted the selected methodology for an investigation that is most appropriate for answering the research questions.
- The fourth chapter has evaluated the results and has assessed it using the method provided in the previous chapter.
- The fifth and last chapter has addressed the conclusion and recommendation of the following investigation.

1.8 Chapter Summary

The introductory chapter has highlighted the concepts and the background information of the following research. The researcher has provided the objectives and questions for the following investigation. After the completion of the chapter, it has been concluded that the lack of research on the financial leverage for the financial institutions has been creating several issues for the organisations and the bans to make the investment decision. They are unaware of the impact of the financial leverage of the organisations and their impact on the return of the company. The next chapter is the literature review that will address the related literature resent on the following study.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter includes the review of different literature which is related to the topic of the study which is the impact of financial leverage over the performance of banking in UK. For conducting the study, the studies that are conducted all over world are included in the study the concept of financial leverage along with its significance is discussed in the chapter in the light of previous literatures. In addition to this there is a detail regarding the concept of organisational performance as well as the importance of analysing it is also present in the study. This chapter also covers the determinants of financial leverage and financial performance by focusing over the relevant literature. After that the chapter also includes the overview of banking sector of UK along with the impact of financial leverage on the banking performance of the UK and the importance of financial leverage in the production of banking companies. The theories which are relevant to the study are also included in the chapter along with the framework which is used in order to conduct the study.

2.2 Concept of financial leverage

Financial leverage is defined as the process in which debt is being used in order to buy more assets. It is analysed that leverage is engaged in order to enhance the return on equity, however, there is too much amount of financial leverage which mainly enhances the failure of risk, which makes more difficulty in repaying the debt. The formula for the financial leverage can be calculated as the ration which is used for total debt to the total assets (Lin, Schmid and Xuan, 2018). As the particular quantity of the debt towards the assets enhances, the quantity of financial leverage also increases. Financial leverage is known to be favourable when they can be used for which debt can bring together to generate the returns greater as compared to the interest expense

which is associated with the debt (Anagnostopoulou and Tsekrekos, 2017). There are number of companies which relies over the financial leverage instead of acquiring more equity capital that would help in reducing the earnings per share of the shareholders.

Furthermore it is analysed that the financial leverage results from using capital that is borrowed which is considered as the source of funding while investing for the expansion of the asset base of the firm and generate the returns over the risk capital (Afolabi, 2019). Financial leverage is considered as the strategy for investment of using the money which is borrowed, specifically in the use of financial instruments or capital which is borrowed and helps in increasing the potential return over an investment. It is analysed from the study by Bhardwaj, (2018) financial leverage is known as the amount of the debt which is used by the firm for financing the assets. When any property, company or investment is considered to be highly leveraged, then it means that this item has more debt as compared to equity. Leverage is known as use of borrowed capital or debt which is used in order to undertake the project of investment. It is analysed that the investors that not tends to use leverage directly have several other ways to access the leverage indirectly (Adenugba, Ige and Kesinro, 2016). They allows in investing the companies which use leverage normally in their business in order to finance as well as expand the operations without enhancing the outlay.

2.3 Significance of financial leverage

As per the study by Choi, Donangelo and Kim, (2019), it is analysed that financial leverage is considered to be very significant as the main advantage of financial leverage is its earnings that are enhanced and tax treatment that is favourable. There is a possibility that financial leverage can

allow the entity in order to earn a disproportionate amount over the assets that a person or business owns. In addition to this another advantage of financial leverage is its favourable treatment of tax, in which there are several tax jurisdictions, the expense of interest is tax deductible that helps in reduction of the net cost for the borrower. However it is also analysed that in financial leverage there is a possibility in which there are disproportionate losses in which the amount which is related to interest expense overwhelms the borrowers if the borrower is not able to earn sufficient returns in order to offset the interest expense (Sajid, Mahmood and Sabir, 2016). This is considered as the particular problem while the interest rates enhance or the rate of return from the assets declines.

It is analysed that the unusual large swings in the profits are mainly caused with the help of heavy amount of leverage which enhances the volatility of the stock price of the company. This is considered as the problem when the operations of accounting should have to be performed for stock options that are issued for the employees, since there are high volatile stocks which are regarded as a valuable and creates a higher compensation expense as compared to the shares that are less volatile (Maia, 2018). Financial leverage is known as an approach which is risky in the businesses which are cyclic or in such businesses in which there are few barriers for entry, since sales and profit are more likely for fluctuating the considerable from year to year, which enhances the risk of bankruptcy over time (Al Momamni and Obeidat, 2017). In short it is analysed that the financial leverage is said to be very significant and it can be earned outsized returns for the shareholders as well as it also presents the complete bankruptcy if the cash flows fall below the level of expectations (Iqbal and Usman, 2018). The concept of leverage can be used by both investors as well as the companies. The investors can mainly use financial leverages in order to significantly increase the returns which can be provided over an investment. They are able to lever the investments with the help of using different instruments in which operations, margin accounts

and futures are included. It is analysed that there is significant impact of the financial leverage on earnings per share, return on equity and current ratio. The banking structure depends over the debt, In addition to this there are number of sources which provides the cash to the bank and makes it easier for them to continue their business process. The main source of money includes the amount being deposited by the account holders, investors, fixed depositors and central banks. The companies are also allowed to use financial leverages in order to finance their assets (Sajid, Mahmood and Sabir, 2016). So, it is analysed that rather than issuing the stock towards the raise capital, the companies are used for debt financing in order to invest in the operations of the business for the attempt by which the value of stakeholder can be increased.

2.4 Concept of organisational performance

Organisational performance is considered as the process which involves the analysis of the performance of the company against the goals as well as objectives. It is also evaluated that the organisational performance consist of the real results as well as outputs which are compared with the outputs which are intended. The main focus of the business analysis is over three main outcomes in which shareholder value performance, financial performance as well as market performance is included (Ringim, Dantsoho and John, 2017). There are several professionals which focus over the organisational performance in which the strategic planners are on top. The organisational performance is very similar to the organisational effectiveness, whereas in organisational effectiveness the broader area is covered (Oladimeji, Akingunola and Sanusi, 2017). Organisational performance is known as the actual output or it is regarded as the results of the organisation that are measured against its intended outputs.

The concept of the organisational performance is considered as the comparison of the goals as well as objectives of the organisation along with the actual performance in three main areas which includes the financial performance, performance of the market as well as the value of the shareholder. Financial performance is known as the results of the organisation with regard to the return over the investment as well as return over the assets. The market performance is known as the ability of the company in order to make as well as distribute the output in such way which is cost effective and set the price which returns the particular amount to the suppliers. In addition to this, the performance of the market refers to the ability of the company for meeting the demands as well as expectations of the consumers which are related to the product or services that are being produced or offered (Al-Swidi, Faiz and Gelaidan, 2019). There are number of organisations that measure the performance of the market with regards to how great a share of the market which is possessed relative to the competitors and some are measured by the ability of achieving the social responsibility. Whereas, shareholder value is known as the value of the person by which they holds the shares in the organisation that they possess (García-Sánchez, García-Morales and Bolívar-Ramos, 2017). So, these three measures are mainly used in order to determine that either the goals of the organisations are achieved or not. Itself organisation does not perform any work but the managers of the organisation are performing the works that are assigned along with the combination of the performed works which is known as the performance of the organisation (Rehman, Seth and Shrivastava, 2016). Along with the resources which are used to run the business, the organisation get several things as the results like effectiveness, development, efficiency as well as participant satisfaction.

2.5 Significance of analysing banking performance

Banks play a basic role in the development of the economy of the nations as they are responsible of the wielding the control to the large extent over the supply of the money in circulation which are considered as the main stimuli of the economic progress. Economic development is considered as the dynamic as well as a process which is continuous that is mainly dependent over the mobilisation of the resources, operational efficiency as well as investment of different segments of the economy (Chen, Jaw and Wu, 2016). Therefore a strong banking sector is considered to be very important for the growth as it helps in creating the jobs, generating the wealth, eradicating poverty, enhances the gross domestic product growth as well as entrepreneurial activities. As the sector of banking is regarded to be very important for the economy of the company, its efficiency is considered to be very important (Jyoti and Rani, 2017). The efficiency can be ensured with the help of healthy financial system along with the efficient economy, the banks should must evaluate as well as analyse carefully.

Moreover, Maer and Broughton (2012) have also added that it is nearly 6.9% of the total economic output. It is one of the largest sectors in London that has a major market share and has an attractive output for the county's economy. According to Timmer (2018), there are nearly 1.1 million jobs in the financial services sector of the UK that equals 3.1% of the total jobs in the UK. Additionally, the exports of the financial sector in the UK is comprised of £60 billion in 2017 and £15 billion within the imports of the country. The following investigation will be based on the top 5 banks in the UK that are HSBC, Barclays, Halifax, Natwest, and Lloyds. The following chapter has provided with the introduction of the study and has developed the relevant background and objectives to be achieved further in this research.

Gatsi, Gadzo, and Oduro (2016) have provided with the assessment that within the context of the banking system, the financial leverage is referred to as the borrowed money that can be used for financial purposes mainly for investment. The study of Corp2020 (2012) has provided with the presence of financial leverage. The study has highlighted that the organisations face several issues and undergo the financial crisis after gaining a higher amount of loans and leverages from other investors. Despite having a positive response, the leverages also have a negative attitude towards the organisations if the company is unable to pay the debt.

The banks plays a major role in helping the business organisation with the help of rendering the great range of the products as well as services. Therefore, it is very important for the banks to analyse the performance of the banks to determine the contribution for the development of the business (Shafiq, Lasrado and Hafeez, 2019). It is inevitable and the banks continuously attract the important devotion from the scrutiny as well as public with the help of financial regulators as there is a need to evaluate the banks in effective and efficient manner. Along with the supervising institutions, regulators as well as management bodies of the banks, the clients if the banks are also considered as the main concern regarding the stability and sustainability of the financial institutions (De Guimarães, 2016). There are several reasons which can be used in order to evaluate the performance of the banks in which the most important reason is to determine the operational results of the banks as well as the overall financial condition, measuring the quality of the assets, managing the quality as well as efficiency and the achievement of the objectives (Kelly and Cameron, 2017). The analysis of eth bank performance includes gathering of formal as well as informal data which can help the customers as well as sponsors in order to define as well as achieve the goal. The banks are expected to provide the evidence for the credit operations as well as financial flows as it impacts the growth as well as economic development of the country (Alsyouf,

et al. 2018). However it is evaluated that the performance cannot have easily measured since there are number of the products as well as services that are intangible in the nature.

2.6 Determinants of Financial Leverage

For every business, the maximization of profits is consider as one of the common goal, for which organisations makes different financial decisions to attain their objectives related to business profitability. As per the study of Ibrahim and Lau (2019), the type of financial decisions that firm normally make are short-term and long-term decisions. In this regard, long-term financial decisions of the company are commonly associated with capital structure, and are mainly revolves around dividends issuance and capital formation. On the other hand, short-term financial decisions are mostly linked with company's working capital and liquidity. In this context, when it comes to making financial decisions of the company, the decisions related to financial leverage holds huge importance for the firms (Hussein and AL-Musawi, 2017). The growing interest in the topic of financial leverage has arose due to its significant impact on wealth to shareholders, profitability, and overall value of the company. Therefore, the examination of financial leverage determinants is important for the policy making of the company.

The study carried out by Wabwile et al. (2014), provides empirical evidence from Kenya regarding the effect of financial leverage on the performance of banks. In the same study, researcher has conducted regression analysis to analyse the impact of financial leverage on bank performance. The variable of financial leverage measured through debt/equity ratio, debt/asset ratio, and times interest earned ratio; whereas the variable of bank performance was measured through return on capital, and return on assets. The findings reveals the negative effect of total debt to equity, and debt to asset on return on capital and return on asset, however none of these

effect are found to be significant. Similarly, in accordance with the study of Onyenwe and Glory (2017), the three of the most common determinants or measures of financial leverage are Debt to Asset Ratio, Debt to Equity Ratio, and Interest Coverage.

2.6.1 Debt to Asset Ratio

Debt to asset ratio is considered as another key indicator of financial leverage of the company, which depicts the proportion of company's total assets that are financed by creditors (Rahman and Rahman, 2017). Similarly, as per the study of Malm and Krolikowski (2017), debt to asset ratio is one of the useful way to determine company's financial leverage, as it portrays the proportion of assets that is funded from borrowings in comparison with the proportion of resources that are funded by investors. In this regard, the higher ratio explains the higher degree of leverage, which ultimately expose the company to high financial risk. Therefore, debt to asset ratio is an important determinant of company's financial leverage.

2.6.2 Debt to Equity Ratio

The study conducted by Kuswanto, Raharjo and Andini (2017), explains debt to equity ratio as a ratio that indicates the relative percentage of debt and equity that is used to funding the business operations. Since, firm's decisions pertaining to financial leverage is mainly linked with the allocation of debt and equity to run the business operation, hence debt to equity ratio has been regarded as a key sign of financial leverage of the company. According to Iqbal and Usman (2018), debt to equity ratio has a huge implication for the shareholders risk and dividends, which eventually influence the market and capital value of the company. Hence, debt to equity is the most essential measure or determinant to consider while examining company's financial leverage.

2.6.2 Interest Coverage

Interest coverage as another important determinant of financial leverage is generally regarded as coverage ratio (Oketch, Namusonge and Sakwa, 2018). As per the same study, this ratio explains the ability of the company to meet its fixed financial debts. According to Greenwald (2019), the main rationale of conducting interest coverage ratio is identify the number of times a firm's EBIT can cover its interest payments. In this regard, the higher ratio of interest coverage shows that company is more debt-free or solvent, which indicates the organisation capability to service debts from their operating incomes.

2.7 Determinants of Financial Performance

It is evaluated that financial performance of any organisation not only play a major role in functioning for raising the value of the market of the particular organisation but it also directs the development of financial sector which leads towards the success of the market. It particularly focuses on business of property as well as its function as engine for the financial development (De Guimarães, 2016). There is an affirmative relationship which is presented for financial improvements as well as development in the economy along with the negative connection among economic distress and development. It is reported that the efforts of reorganization of finance which is paid off with high competence and development. The segment dealing with finance is considered to be very important in nature for financial enlargement which facilitates recruitment of funds (Shafiq, Lasrado and Hafeez, 2019).

The firm's finance and investment decisions are closely analysed by major actors in financial market, which includes investors, creditors, and potential investors (Sharma, Jadi and Ward, 2020). For that purpose, different financial market actors tend to utilise wide range of financial ratios to better analyse the firm financial performance, and to measure how effectively

the firm is managing its resources. According to Purwaningtyastuti, Titisari and Nurlaela (2018), some of the most common ratios that are generally viewed as the key determinants of company's financial performance are earning per share (EPS), return on equity (ROE), net income margin, and liquidity (Current Ratio).

Moreover, Maer and Broughton (2012) have also added that it is nearly 6.9% of the total economic output. It is one of the largest sectors in London that has a major market share and has an attractive output for the county's economy. According to Timmer (2018), there are nearly 1.1 million jobs in the financial services sector of the UK that equals 3.1% of the total jobs in the UK. Additionally, the exports of the financial sector in the UK is comprised of £60 billion in 2017 and £15 billion within the imports of the country. The following investigation will be based on the top 5 banks in the UK that are HSBC, Barclays, Halifax, Natwest, and Lloydds. The following chapter has provided with the introduction of the study and has developed the relevant background and objectives to be achieved further in this research.

2.7.1 Earnings per Share (EPS)

This ratio represents the proportion of the overall firm's profitability that is distributed to each individual share of the stock (Batchimeg, 2017). In accordance with the same study, the earning per share ratio carries out huge importance for investors, and for individuals who practice trading in stock markets. The high ratio of EPS reflects the higher company's profitability (Mohapatra, 2019); hence, it is the important determinant to consider while measuring company's financial performance. In the existing literature, there are several studies in which earning per share have been identified as an important determinant of financial performance (Arabsalehi and Mahmoodi, 2012; Bogdan, Ban and Popa, 2017).

The metric of earning per share is regarded as one of the critical variables which helps in determining the value of the share and the company. It is mainly used in calculating the price to earnings (P/E) valuation ratio in which P/E denotes EPS. If the share price of the company is divided by its earnings per share, the investors can oversee the value of the stock which is the value by which market is willing to pay for every dollar earned (Chen, Jaw and Wu, 2016). EPS is known as one of the indicators which can be used to select the stocks to invest in. If anyone has interest in the stock trading or investing, the next step would be choosing a broker which works for investment style (Jyoti and Rani, 2017). Comparing EPS in the terms which are absolute may not mean much to the investors as ordinary shareholder have no direct access for the earnings. Instead of this the investors would compare the EPS with the share price of the stock for comparing share price and EPS in order to determine the value of earnings.

2.7.2 Return on Equity (ROE)

Return on equity (ROE) is considered as another important ratio that is used to predict the financial performance of any company. As mentioned in the study of Rai et al. (2018), ROE is a profitability ration that shows the amount of company's profitability that is generated as a proportion of shareholder's equity. According to Daly and Frikha (2017), the ROE ratio is an important measure of company's performance, as it explains the company capability to generate cash internally. The study carried out by Garba, A. and Sulaiman (n.d), provides empirical evidence from quoted agriculture firms in Nigeria where the impact of financial leverage on financial performance was assessed. The same study has used return on equity (ROE) as one of the determinant to measure financial performance. Moreover, the findings of the study reveals that

there is no significant impact of long-term debt on financial performance, whereas short-term debt was found to have significant but negative effect on financial performance.

Return on equity is known as the measure which is used for measuring the financial performance calculated by dividing net income from the equity of shareholder as the equity is equal to the asset of the company and the debt is minimized from this, so ROE is considered as the return on net assets (Sajid, Mahmood and Sabir, 2016). ROE is also known as the measure of the way by which effective management uses the assets of the company for creation of profits. It is expressed in percentage and it can be calculated for the company in case net income as well as equity are denoted by positive numbers (Oketch, Namusonge and Sakwa, 2018). Net income can be calculated before dividends are paid to the shareholders which are common as well as after dividends preferred shareholders as well as interest to the lenders.

2.7.3 Net Income Margin

Net income margin is also recognised as profit margin, which explains the overall profitability of the company. This ratio measures the net profit or income that is generated as a proportion of company's revenues (Ferrouhi, 2018). In other words, net profit margin refers to the proportion of revenues remained after all the interest, preferred stock dividends, operating expenses, and taxes have been excluded. Hence, net profit margin is one of the most useful financial measure to analyse the performance of any business. The study conducted by Perinpanathan (2014), provide empirical findings from Sri Lanka where net income margin was taken as one of the major determinant of financial performance. The findings of the same study reveals negative association between financial leverage and financial performance of the companies.

The net income margin can be defined as the margin which is equals to the amount of net income or profit which is generated as the percentage of revenue over a financial period. Net profit margin is known as the ratio of net profits for the company which is typically expressed in percentage but it is also represented in decimal form (Matar and Eneizan, 2018). It mainly illustrates the amount how much of every dollar in the revenue can be collected by the company which can be translated in the profit. It is also known as the bottom line for the company or net profit (Ferrouhi, 2018). Net profit margin is also known as the net margin. The term net profit is said to be equal to the net income over income statement and can be used interchangeably.

2.7.4 Liquidity (Current Ratio)

Current ratio is viewed as one of the most prominent metrics that is commonly utilised across different industries to measure the firm's short-term liquidity relative to its impending liabilities and available assets (Matar and Eneizan, 2018). As per the same study, this ratio reflects the ability of the company to generate sufficient amount of cash to pay-off all of its debt. Therefore, this capability of the company is commonly viewed as an important measure to assess financial health of that company.

Liquidity is known as the ease which is used to convert asset or security in the cash without its affects over market price. In other words, liquidity is known as the degree by which assets can be bought or sold in the market at the price which reflects the intrinsic value (Jyoti and Rani, 2017). Cash is known as the most liquid asset which is used universally as it is known as such asset which can be easily converted in other assets (Chen, Jaw and Wu, 2016). Other liquid assets include tangible assets like fine art, real estate as well as collectibles. The financial assets ranges from equities of partnership unites which fall at several places in spectrum of liquidity.

2.8 Overview of banking sector in UK

It is observed that the economic output of the country have been slowed by the end of 2018 by 1.4% which is recorded to be the lowest rate after 2011. This slowdown was observed due to the contraction in the investment of the business and widens the net trade deficit which has been dragged down output from the household consumption which is stable and is supported by the annual wage growth of 3.5% which results in expanding the spending of the government (Garavan, et al. 2020). During such years the annual rate of consumer price inflation have peaked in the past years at 2.1% which was just above the target of Bank of England. The rate of official bank was raised from 0.5 to 0.75% (Bakotić, 2016). The rate of unemployment continues to fall while these years to 4% while the employment records the height of 76.1%. The household saving ration of gross saving for the total disposable income was 4.8% in the final quarter of 2018 which maintains the historically low trend from past two years (De Guimarães, 2016). It is also analysed that the consumers as well as business confidence measures have weakened while 2018 which have amid continued uncertainty which is linked with the economic as well as trading impacts of proposed withdrawal of UK from the EU (Ringim, Dantsoho and John, 2017).

2.10 The Impact of Financial Leverage on the Banking Performance of UK

As per the study of Kiet, and Thuan, (2019), financial leverage for the banking sector is the most important element as the banks are usually operating on the fixed amount of profit which is being earned through the interest earned upon the loans provided by the bank. On the other hand, it has also been studied that the banking structure mainly rely over the debt as there are number of sources which provides the cash to the bank and makes it easier for them to continue their business

process (Oketch, Namusonge, and Sakwa, 2018). Sources of money for the banks are the amount being deposited by the account holders, investors, fixed depositors and central banks. Therefore, it makes clear that the banks are also liable to pay interest to those who have invested in the banks. In addition to that, it was studied that the rate of interest that the banks collect from the borrowers and the rate of interest being paid by the banks is different (Sodeyfi, 2016). However, the banks are the bodies which reduce the risk of investors therefore they also pay the lower amount of interest to their investors.

This makes it clear that the probability to earn profit is directly proportional to rate of risk that the investor is going to bear. Furthermore, it has also been studied that the banks usually have staff and procedures to evaluate the risk before providing loans and assure their investment will be recovered in each possible outcome (Bui, 2020). However, if a bank is lacking in terms of evaluating the risk, there are chances that they would have to bear financial losses in near future which will directly affect their performance. In case of UK banking sector, it was studied that the leverage of banking sector is higher than the other countries as most of the people in UK are relying over debt even for their basic necessities of life (Elahi, 2017). Therefore, this cycle has increased the rate of risk for the banks operating in UK.

2.11 Importance of Financial Leverage in the Production of Banking Companies

There are sufficient number previous studies that have identified financial leverage as an important component for the production of banking companies. As mentioned in the research of DeAngelo and Stulz (2013), financial leverage in banking industry is considered to be much higher in comparison with any other industry. The high financial leverage is normally viewed as a positive sign for firm value, as it tends to enhance the performance and efficiency of the firm. However, high financial leverage ratio sometime lead towards high agency cost due to different interests

amongst debt holders and shareholders (Ebiringa and Ezeji, 2012). Therefore, the significance of financial leverage is highly associated with the identification of optimal level of leverage that firm's needs to maintained. However, in the context of banks, having higher leverage ratio is considered to be safer as compared to any other company. This is mainly due to the reason that banks commonly utilise their own capital to make investment or loans or sell-off it's most risky and leveraged assets (Dey, Hossain and Rahman, 2018). The same study identifies financial leverage as the most crucial option for banks to have for diversifying its financing risk, and to ensure the maximum production of the bank.

According to Abubakar (2015), high financial leverage is highly important and optimal element of banks capital structures, when liquidity is valued at premium because of demand for certain access to capital. Moreover, the high competition in the banking industry often lead towards squeezing liquidity of the bank, and loan spread decreases equity value; thus, having the optimal level of financial leverage is highly critical for banks to sustain their competitiveness in the market, and to enhance their production. As per the study of Kalemli-Ozcan, Sorensen and Yesiltas (2012), financial leverage has the huge potential to enhance overall bank performance, if it is well managed and structured. Therefore, it is the responsibility of the bank's management to manage financial leverage appropriately, and ensure optimal level of leverage to accomplish desire business objectives. Similarly, the study carried out by Kiet and Thuan (2019), stresses on the importance of identifying the most ideal level of leverage for banks to make sure that financing risk should not exceed too far from the tolerable limit, which as a result may lessen the returns to shareholders and negatively affects the overall profitability of the organisation. Conclusively, financial leverage holds huge importance for the production of banking companies.

2.12 Theoretical Framework

2.12.1 Trade-off Theory

The trade-off theory holds the view that organisations must need to manage ideal level of debt ratio by analysing the cost and benefits of borrowings. As stated in the study of Onyenwe and Glory (2017), the concept of trade-off theory explains that ideal level of firm debt ratio can be determine by a trade-off between the tax advantage and bankruptcy cost of borrowing. In this regard, trade-off theory suggest that companies can consider borrowing up to the extent where tax marginal value protects on extra debt is just balance by the increase in current value of probable cost of financial distress. This theory assumes that company is likely to have an ideal level of capital structure on the basis of trade-off between benefits and cost of using debt (Nicodano and Regis, 2019). Thus, by using this approach companies can identify the appropriate level of financial leverage.

2.12.2 The Irrelevancy Theory

The irrelevancy theory posits that financial leverage does not make any significant influence on overall value of the company, if it is not faced with distress cost and income tax (Al-Kahtani and Al-Eraij, 2018). This theory is mainly based on the belief that there are efficient markets, and investors does not experience any tax and transaction cost while selling and buying securities. Acccoring to Udobi and Iyiegbuniwe (2018), the irrelevance theory also postulates that market value of any company is identified by its capability to earn and risk that is associated with its underlying assets. Hence, in this context the WACC needs to be stay constant. Moreover, this theory also argues that company's value is not influenced by its capital structures, but it's the asset earning capability that determines the firm value. However, the overall view of this theory is highly criticised as it has not consider the element of distress costs and income tax.

2.13 Conceptual Framework

Independent Variables

Variables

Dependent



The above-mentioned conceptual framework highlights key dependent and independent variables of this study. As highlighted in the above presented framework, the independent variable of this study is financial leverage, whereas the dependent variable is financial performance. In order to examine the impact of financial leverage on financial performance of the banks, the sub variables of both independent and dependent variables are also highlighted. In this regard, financial leverage is measured through the variables of debt to equity ratio, debt to asset ratio, and interest coverage. On the other hand, financial performance has been measured through earnings per share (EPS), return on equity (ROE), net income margin, and liquidity (Current ratio).

2.14 Chapter Summary

This chapter of the study is providing the review of related literature regarding the financial leverage in banking sector of UK. Structure of the study is being set drafted in a way that the concept and significance of financial leverage is being discussed in order to develop the

understanding of the reader about the main aspect of the study. Furthermore, the second element of the study is banking performance, therefore its concept as well as the significance has also been discussed in this chapter. Later to that, their determinants and the overview of UK banks have been provided along with the impact of financial leverage on the banking sector of UK. In addition to that, importance of financial leverage on the banking performance of UK was also discussed before the sections of theoretical and conceptual frameworks.

CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

This chapter is providing the most essential element of the study that is methodology. Methodology which is being used in this study is not only explained but also justified with the justification which is being taken from the secondary studies conducted by various researchers regarding the selection of the methodology. Various sections which have been included in this chapter are providing the details regarding the methods such as what was the research philosophy of the study, approach, design and others. However, the sections regarding the sampling and data collection are also being included in this chapter along with section of research limitations and ethical consideration.

3.2 Research Philosophy

When it comes to discuss about the research philosophy, it has been studied that there research philosophies that are usually being used are of four types which have been used to conduct any study such as realism, pragmatism, positivism and interpretivism (Edson, Henning, and Sankaran, 2016). Furthermore, it has also been studied that it is necessary that the research philosophy should be conducted in a way that all the requirements of the study should be catered (Cole, 2020). In this study, the applied philosophy is positivism as the topic which was selected by the researcher is investigating that how financial leverage impacts over the performance of banks in UK banking sector. In such a case, where the researcher is studying about the impact of one element over the other, it is necessary to analyse that the study will be focused on natural phenomenon which will be examined through the factual information collected from any authentic source.

Therefore, positivism is being applied in the study to investigating that how financial leverage impacts over the performance of banks in UK banking sector. In addition to that, it has also been studied that this philosophy is being used for the studies where the results would not be changed until the circumstances remain same, therefore the findings can be generalised for all other contexts with similar topic (Sapkota, 2019).

3.3 Research Approach

It has been studied that two types of approaches are being used in research that can be selected for any study such as inductive or deductive research approach (Buesching, and Jordan, 2019). However, the selection of the research approach is being made upon some elements which are necessary to be analysed. The major aspect which is necessary to be analysed before the research approach selection is that whether the similar topic regarding the study has been studied ever before or not (Tuffour, 2017). In such a case, where the similar study has been conducted previously, the deductive research approach is being applied or vice versa.

In this research, deductive approach has been used to conduct the study, as the similar topic has already been studied by previous researchers. In addition to that, deductive research approach demands the researcher to select a hypothesis and test it with the findings of their study. Therefore, in this study, researcher has tested the previously developed hypothesis with the factual information being collected from the companies' financial statements. However, inductive research approach collects the information and develops a hypothesis in the end of the study.

3.4 Research Design

Research design is being decided based upon the philosophy and the approach of the study as there is an impact of research philosophy and approach over the research design of the study.

Mainly there are two research designs such as qualitative and quantitative, however, the third design is the combination of these two designs which is mixed method (Leavy, 2017). In case, where the quantitative research design is being selected, there will be various options to use for data collection while the information will only be collected in the form of numbers. On the other hand, qualitative research design demands the researcher to collect the information in detailed form, wither from secondary information or primary information.

In this study, applied research design is secondary quantitative, which means that the information is being collected from the secondary resources in the quantitative form. In addition to that, difference between the secondary and primary information is that primary information is that which has been collected primarily by the researchers, while the secondary information is being collected by any other person for their own objectives. Similarly in this study, secondary information resources are being used for data collection, however, the information taken from secondary resources is being referenced.

3.5 Methods of Data Collection

Methods of data collection are different for the quantitative and qualitative studies with respect to the factor that either the information is being collected through the primary resources or secondary resources (Adler, Fulton, and Hoegeman, 2020). In such a case, where the quantitative information is being collected from the primary resources, the information can be collected through the survey questionnaire or of the secondary information is being collected, researcher can look for the authentic resources for data collection. Conversely, if the data is being collected in qualitative form from the primary resources, researchers can use the interview questionnaire which can be structured or unstructured depending on the need of the research. However, secondary

qualitative information is being taken from the research articles, journals, news or authentic websites.

In this study, information is being collected through the secondary qualitative form and for that particular reason, researcher has used the annual reports and online websites such as Reuters and others to collect information regarding the financials of the banks. In addition to that, it is also necessary to mention that the information regarding the financials of the banks is consisting of two factors such as their financial ratios and financial performance. When it comes to discuss about the financial ratios of the banks, researcher has collected the information regarding the debt to asset ratio, debt to equity ratio and interest coverage. However, financial performance is being measured through the return on equity, equity per share, net income margin and liquidity of the banks. Moreover, the information regarding these variables have been collected for the selected duration of 10 years which is from 2009 to 2018.

3.6 Sample size

When the researchers are required to collect the sample for the study, it is necessary to undertake that sample size of the study should be selected in a way that the target population of the study should be represented appropriately (Schönbrodt, and Perugini, 2018). In addition to that, it has also been studied that the sample size of the study is also dependent over the fact that wither the study is being conducted with qualitative information or quantitative information (Malterud, Siersma, and Guassora, 2016). Therefore, in this study, the sample size is 5 banks of UK. As this study was conducted investigate that how the financial leverage affects the banking performance in UK, therefore, it was necessary that the sample should be selected from the banks of UK which should be listed in the stock market of UK. In this study the data has been collected over the defined

parameters from the list of five banks which includes Barclays, Lloyds, HSBC, NatWest and Halifax.

3.7 Sampling technique

Sampling technique refers to the method used for the selecting the sample of the study, and it has been studied that there are various types of sampling techniques which can be used for any study (Taherdoost, 2016). However, the sampling technique is being selected based upon the type of the study and the target population of the study. The most important element while selecting the sampling technique is that how the researcher will approach the respondent. As per the study of Kim, Kwon, and Paik, (2016), there are mainly two types of sampling techniques such as probability and non-probability sampling technique. However, there are various techniques under these two heads.

In this study, where the secondary information was required to be collected regarding various aspects of the banks it was necessary to select a sampling technique that should be justified for this study. Therefore, analysing the criticalities of this study, researcher has selected the cluster sampling technique which allows the researcher to select a sample by making clusters where the target population of the study is being divided on the basis of their characteristics. In this study, the banks are being selected on the basis that they should be listed in the stock market of UK. Therefore, cluster sampling technique is being used in this study which is a part of probability sampling.

3.8 Data analysis technique

Techniques used for data analysis are being selected on the basis of the fact that what method of research is being used in the study. In this study, where the secondary quantitative

information was selected for the various elements of the UK banks, it was necessary that the statistical mathematic tests should be applied in order to obtain the findings of the study. Therefore, in this regard, correlation and regression are the two tests which have been used in this study (Gunst, 2018). However, the application of these tests is different to each other as the correlation tests is being used to find out the linkage between the factors of the study to assure that whether there is a relation between them or not. On the other hand, regression analysis has been used to find out the effect of financial leverage on the performance of the banks. As the major objective of the study was to identify the impact of financial leverage on the performance of banks in UK, therefore, four factors were identified in this study regarding the financial leverage such as equity per share, return on equity, net income margin and liquidity. By the application of regression analysis, researcher has checked the impact of these factors over the banks' performance and presented the findings. Regression analysis is a powerful statistical method which helps businesses for assessing the impact of one or more variables over another (Abadie, et al. 2020). It also helps the researcher to understand the idea regarding the data points which helps in analysing the relationship among data sets in order to achieve better results (Levine, et al. 2017). In addition to that, impact of financial leverage on performance of the banks have been evaluated by using the below mentioned model.

The first model for the study evaluates the effects of financial leverage on earnings per share:

$$EPS = \alpha + \beta_1 DebtEq + \beta_2 DebtAst + \beta_3 IC + \mu_{it}$$

The second model of the study focuses in evaluating the effects of financial leverage on return on equity:

$$ROE = \alpha + \beta_1 DebtEq + \beta_2 DebtAst + \beta_3 IC + \mu_{it}$$

The third model of the study focuses on evaluating the effects of financial leverage on Net income margin

$$NI = \alpha + \beta_1 DebtEq + \beta_2 DebtAst + \beta_3 IC + \mu_{it}$$

The fourth model of the study focuses in evaluating the effects of financial leverage on Liquidity

$$Lqdt = \alpha + \beta_1 DebtEq + \beta_2 DebtAst + \beta_3 IC + \mu_{it}$$

3.9 Ethical consideration

It has been studied that there are some of the ethical considerations that are required to be undertaken by every researcher such as every information taken from any other research, article, journal or any other resource should be credited to the real author of the study (Njie-Carr, et al., 2019). Furthermore, it is also important the collected information should be used for the said purpose of the study which should be specified before the data collection. In addition to that, research should never include the perception or any other aspect from the researcher which could not be justified by the findings of previous researches as it may increase the probability of biasness in the study.

3.10 Research Limitations

Similar to any other study, there are some of the limitations as well in this study such which should be clarified by the researcher itself (Cooke, 2018). In such a case, where the research imitations are not disclaimed by the researcher, there are chances that the future researcher may consider it as the weaknesses of the study. Therefore, in this study, major limitation was the time constraint as well as the budget constraint as the researcher was required to conduct the study in

limited time and budget. In addition to that, sample size is also limited in this study, therefore, there are chances that the larger sample size of the study or including factors in this study may affect the findings presented by the researcher. There are some of the limitations of PLS-SEM such as it needs a coefficient of structural path having high value in case of small sample size. Multicollinearity is hard to handle in this software. Undirected models cannot be identified due to the single ended arrows in it (Wong, 2013). When it comes to estimate the path coefficient it may create an error in large mean square as well. Therefore, it is needed that the software should be used in an efficient manner.

CHAPTER FOUR: FINDINGS AND ANALYSIS

4.1 Introduction

The chapter demonstrates empirical analysis regarding the effect of financial leverage on the on financial performance and liquidity position of the publicly listed Banks in United Kingdom. For this purpose, descriptive statistics has been used to describe the variables of the study correlation has also been conducted to examine interrelation among the financial leverage and financial performance of the banks. In addition to this, empirical investigation has also been conducted through panel least square regression to evaluate how much financial leverage has been affecting and influencing the financial performance and liquidity position of the Banks operating in United Kingdom. In addition to this, discussion on the findings of the study has also been conducted to discuss how much objectives of the study are achieved.

4.2 Descriptive Statistics

	D/E	D/A	EOP_L_EOP_D	EPS	ROE	NPM	Current Ratio
Mean	2.19	0.12	0.80	0.73	0.08	0.09	1.04
Median	2.17	0.11	0.69	0.24	0.09	0.06	1.14
Maximum	4.83	0.24	1.25	3.63	0.20	0.44	1.35
Minimum	0.41	0.01	0.57	-0.87	-0.03	-0.15	0.34
Std. Dev.	1.09	0.05	0.21	1.07	0.05	0.12	0.30

The mean debt to equity ratio of a bank is 2.19 (SD 1.09) and this implies that on average a bank has debt to equity ratio of 2.19 that could also deviate by 1.09. It is because the debt to equity differs by bank. It can also be interpreted as that on average a given bank owes £2.19 in debt against each £1 of equity; this makes double than equity that is normal for a bank and financial institution. Furthermore, the debt to assets (D/A) of the bank is 0.12 (SD 0.05) that implies on average 15% assets of the banks are financed by debt and remaining by other liabilities and total

equity. On the other hand, the average loan to deposit ratio of a given bank is 0.8 with standard deviation 0.21 suggesting that 80% of the loans have been made to customers from bank's own deposits without relying on the external deposits and that is an indication of bank's effective leverage.

In addition to, the mean earnings per share (EPS) of the bank is 0.73 with standard deviation 1.07 and this suggests that on average banks have generated a positive value for the shareholders. Since, the standard deviation of the EPS is higher than mean hence it can be evident that many banks' also have experienced net loss and have generated negative value for the shareholders. Furthermore, the mean return on equity (ROE) of the banks is 0.08 or 8% with standard deviation 0.05 or 5%; thus, this infers that a typical bank generates 8% return over the equity employed by shareholders but this mean value could deviate by standard deviation. Lastly, mean net profit margin of the banks is 0.09 or 9% with SD 0.12 (12%); but since the SD is greater than mean hence this implies that banks have also experienced a negative return previously; but on average could generate a net margin of 9% in a given period. Lastly, mean current ratio of the banks is 1.04 (SD 0.30) suggesting that on average a bank has stronger liquidity position to meet with the current liability's obligations but some of banks also have lower liquidity.

4.3 Pearson's Correlation

The correlation refers to the association within the quantitative variables or observations; the relation may exist within the variables but the core purpose is to evaluate the association from different dimensions to draw implications. For this purpose, scholars have referred Pearson's correlation technique as more effective in evaluating the interrelation. In this regard, Gogtay and Thatte (2017) states that Pearson's correlation can highlight that either relation between the variables is positive or negative that refers to direction of association. Similarly, the authors further

explain that Pearson's correlation also assists in determining strength of the relation that is represented by the value of coefficient which if remains less than 0.5 then relation can be stated as weak. However, if the value of coefficient is greater than 0.5 then relation can be stated as strong; and at the same time significance of the relation is also important to be considered (Schober, Boer and Schwarte, 2018). The significance of relation provides an empirical evidence that either relation between the said variables is statistically significant or not. It means if the relation is statistically significant then relation is also important on which implications can be drawn but if relation is not statistically then relation is not important from empirical point of view and may also be misleading to interpret.

Probability	D/E	D/A	EOP_L_EOP_D
EPS	0.213	0.215	-0.489
	0.160	0.156	0.001
ROE	-0.206	-0.092	-0.417
	0.174	0.546	0.004
NPM	-0.138	-0.228	-0.040
	0.367	0.131	0.792
Current Ratio	-0.061	-0.369	0.432
	0.692	0.013	0.003

The coefficient between debt to equity and EPS is 0.21 (p-value 0.160) implying that relation between the variables is positive weak but is not statistically significant since p-value is greater than significance. Hence, this infers that relation of debt to equity with EPS is not important and that their relation may not influence each. Furthermore, the correlation of debt to equity with

ROE, NPM and current ratio is negative and statistically insignificant as -0.206 (p-value 0.174), -0.138 (0.367) and -0.061 (0.692) respectively. It can be interpreted as that there is no evidence of significant relation between these variables hence it can be stated that it is not necessary that debt to equity could negatively influence since the relation is not significant.

The coefficient between debt to assets and EPS is 0.215 (p-value 0.156) implying that relation between the variables is positive weak but is not statistically significant since p-value is greater than alpha level 0.05. Therefore, this infers that relation of debt to equity with EPS is not important and that their relation may not influence each based on insignificant relation. Furthermore, the correlation of debt to assets with ROE and NPM is negative and statistically insignificant as -0.092 (p-value 0.546) and -0.228 (0.131) but has negative and significant relationship with current ratio as coefficient and p-value of the relation is -0.369 (0.013). Therefore, it is evident that ROE and NPM have no relation with debt to assets but current ratio has weak negative and significant relation. Hence, it can be said that if the debt to asset ratio increases then it would reduce the current ratio position of the company based on the fact that higher debt level tends reduce portion of current assets relatively thus ratio would also decline.

Furthermore, the relation of loan to deposit with EPS and ROE is negative -4.89 (p-value 0.001) and -0.417 (p-value 0.004) and this implies that current ratio has positive and significant relation. Hence, it is evident that loan to deposit has no relation with EPS and ROE but has positive and significant relation with current. This implies that if the loan to deposit ratio increases then it is more likely that current ratio of the banks would improve as a result.

4.4 Multiple Regression

Multiple regression has been widely used to determine how much repressors have been affecting the regress and variable in the model (Schneider, Hommel and Blettner, 2010).

Meanwhile, in following study panel least square was used based on the fact that data of the study was panel data of 10 years for five banks. This technique has been used to examine the how financial leverage has been affecting the financial performance of banks and liquidity position; for this purpose, regression was conducted four times since study has four different independent variables and results of the study are present as follows.

4.5 Effect of Financial Leverage on Earning per share (EPS)

Dependent Variable: EPS				
Method: Panel Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DEBT_TO_EQUITY	0.93	0.31	2.93	0.00
DEBT_TO_ASSET	-11.19	6.04	-1.85	0.07
EOP_L_EOP_D	-4.20	0.73	-5.75	0.00
CURRENT_RATIO	0.68	0.52	1.31	0.19
C	2.73	0.85	3.18	0.00
R-squared	0.48			
Prob(F-statistic)	0.00			

The first model of regression was used to determine how financial leverage affects earning per share (EPS); the coefficient of determination or r-square of the model is 0.48 that shows that model can explain 48% variability of the EPS. It means the debt to equity, debt to assets, loan to deposits ratio and current ratio as independent variables can estimate 48% variability of the EPS but remaining is residual of the model that is also known as error term (Lunt, 2015). Furthermore, referring to the significance of the model, then it is evident that model is significant since p-value of the model is 0.000 implying that there is no chance or at least chances less than 5% that results

are due to model error (Nimon and Oswald, 2013). Hence, the results can be used to draw implications for practical applications. Meanwhile, coefficients show that if there is one unit of change into the debt to equity, debt to assets, loan to deposits and current ratio then earning per share of the banks would change by 0.93 (p-value 0.00), -11.19 (p-value 0.07), -4.20 (p-value 0.00) and 0.68 (p-value 0.00) respectively. Therefore, it can be interpreted that debt to equity has positive and significant effect on EPS but effect of debt to assets and loan to deposit is negative and significant; hence would influence EPS negatively and EPS has no effect on the EPS. Hence, it is evident that if debt to assets increases then EPS would significantly improve but could also be negatively affected if debt to assets and loan to deposits increases. This has also been identified from the literature that that financial leverage is known to be favourable when it can be utilised for which debt can bring together for the purpose of generating the returns greater in contrast to the interest expense which is associated with the debt (Anagnostopoulou and Tsekrekos, 2017).

4.6 Effect of Financial Leverage on Return on Equity (ROE)

Dependent Variable: ROE				
Method: Panel Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DEBT_TO_EQUITY	0.03	0.02	1.36	0.18
DEBT_TO_ASSET	-0.76	0.36	-2.10	0.04
EOP_L_EOP_D	-0.13	0.05	-2.93	0.01
CURRENT_RATIO	-0.06	0.03	-1.58	0.12
C	0.29	0.05	5.50	0.00
R-squared	0.285276			
Prob(F-statistic)	0.003876			

The second model of regression was used to determine how financial leverage affects return on equity (ROE); the coefficient of determination or r-square of the model is 0.28 that shows that model can explain 48% variability of the ROE. It means the debt to equity, debt to assets, loan to deposits ratio and current ratio as independent variables can estimate 28% variability of the ROE but remaining is residual of the model that is also known as error term (Lunt, 2015).

Furthermore, referring to the significance of the model, then it is evident that model is significant since p-value of the model is 0.003 that indicates there is no chance or at least chances less than 5% that results are due to model error (Nimon and Oswald, 2013). Thus, results of the study could be trusted given that model meets with the significance criteria. Meanwhile, coefficients show that if there is one unit of change into the debt to equity, debt to assets, loan to deposits and current ratio then return on equity of the banks would change by 0.03 (p-value 0.18), -0.76 (p-value 0.04), -0.13 (p-value 0.01) and -0.06 (p-value 0.12) respectively. Therefore, it can be interpreted that debt to equity has positive but statistically insignificant effect on ROE but effect of debt to assets and loan to deposit is negative and statistically significant; hence would influence ROE negatively and there is no evidence of effect of current ratio effect on the ROE. Therefore, it is can be stated that if the debt to assets and loan to deposits ratio declines then it could improve the return on equity. This contradicts with the findings of literature that the ROE ratio is an important measure of company's performance, as it explains the company capability to generate cash internally (Daly and Frikha, 2017).

4.7 Effect of Financial Leverage on Net Profit Margin (NPM)

Dependent Variable: NPM				
Method: Panel Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DEBT_TO_EQUITY	0.04	0.04	0.97	0.34
DEBT_TO_ASSET	-1.01	0.75	-1.34	0.19
EOP_L_EOP_D	-0.14	0.09	-1.49	0.14
CURRENT_RATIO	0.08	0.07	1.06	0.30
C	0.17	0.11	1.58	0.12
R-squared	0.14			
Prob(F-statistic)	0.14			

The third model of regression was used to determine how financial leverage affects net profit margin (NPM); the coefficient of determination or r-square of the model is 0.14 that shows that model can explain 14% variability of the NPM. It means the debt to equity, debt to assets, loan to deposits ratio and current ratio as independent variables can estimate only 14% variability of the NPM but remaining is residual of the model or error term (Lunt, 2015). Furthermore, referring to the significance of the model, then it is evident that model is not statistically significant since p-value of the model is 0.14 implying that there are higher chances that results contains errors greater than 5% and this is sufficient evidence that results cannot be trusted (Nimon and Oswald, 2013). Therefore, interpretation of the coefficients would also be meaningless since model contains errors and lacks explaining the net profit margin. However, the findings from the literature suggests that net profit margin is one of the most useful financial measure to analyse the performance of any business (Ferrouhi, 2018).

4.8 Effect of Financial Leverage on Liquidity (Current ratio)

Dependent Variable: CURRENT_RATIO				
Method: Panel Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
DEBT_TO_ASSET	-5.48	1.31	-4.19	0.00
DEBT_TO_EQUITY	0.25	0.07	3.57	0.00
EOP_L_EOP_D	0.20	0.19	1.09	0.28
C	1.00	0.16	6.09	0.00
R-squared	0.4038			
Prob(F-statistic)	0.0000			

The fourth model of regression was used to determine how financial leverage affects current ratio; the coefficient of determination or r-square of the model is 0.40 that shows that model can explain 40% variability of the liquidity. It means that debt to equity, debt to assets, loan to deposits ratio and current ratio as independent variables can estimate 40% variability of the current

ratio but remaining is residual of the model or error term (Lunt, 2015). Furthermore, referring to the significance of the model, then it is evident that model is significant since p-value of the model is 0.000 implying that there is no chance or at least chances less than 5% that results are due to model error (Nimon and Oswald, 2013). Therefore, the results of the model could be trusted and used for interpretation as model explains the variability significantly. Meanwhile, coefficients show that if there is one unit of change into the debt to equity, debt to assets and loan to deposits then current ratio of the banks would change by -5.48 (p-value 0.00), 0.25 (p-value 0.00) and 0.20 (p-value 0.00) respectively. Therefore, it can be interpreted that debt to equity has positive and significant effect on current ratio but effect of debt to assets is negative and significant and loan to deposit has insignificant effect. This means lowering the debt to assets ratio could improve liquidity position of the banks whereas debt to equity ratio could improve the ratio. In contrast, loan to deposits ratio has been found to have no effect on the current ratio of the company. This has also been aligned with the findings of Matar and Eneizan (2018) which states that ratio reflects the ability of the company to generate sufficient amount of cash to pay-off all of its debt.

4.9 Discussion

Objective 1: To study the concept and significance of financial leverage

The first objective of the study was to study the concept and significance of financial leverage. In this manner, it has been identified that financial leverage is the process in which debt is being used for the purpose of buying more assets. It is analysed that leverage is engaged to improve the return on equity, though, there is an extreme amount of financial leverage which mainly enhances the failure of risk while making it tougher to repay the debt. This has also been argued in the study of Anagnostopoulou and Tsekrekos (2017) that financial leverage is known to be favourable when it can be used for which debt can bring together for the purpose of generating

the returns greater in contrast to the interest expense which is associated with the debt. Moreover, according to Afolabi (2019), it has also been identified that financial leverage is due to the use of borrowed capital which is considered as the source of funding while investing for the expansion of the asset base of firm and generating the returns over the risk of capital.

Pertaining to the significance of the financial leverage, it has been identified that financial leverage helps the company in terms of earnings and tax reduction. This has also been argued in the study of Choi, Donangelo and Kim, (2019) that financial leverage is considered to be significant as the major advantage of financial leverage is its enhanced earnings and favourable tax treatment. In addition to this, there is also a possibility that financial leverage may allow the entity for earning a disproportionate amount over the assets which the business owns. However, the study of Sajid, Mahmood and Sabir (2016) stated that due to the financial leverage, there is a likelihood of inconsistent losses in which the related extent of interest expense overwhelms the borrowers if the borrower is not able to earn adequate returns for the purpose of offsetting the interest expense. Despite of this, the financial leverage is regarded as an suitable substitute when the company is operating in a sector along with the steady revenue level, high barriers to entry and large cash reserves, therefore the operating conditions are sufficiently steady for supporting in a large amount of leverage with little downside.

Objective 2: To identify factors affecting the performance of an organisation

The second objective of the study was to identify the factors affecting the performance of an organisation. In this manner, it has been identified through the discussion that factors that affect the performance of the organisation include earnings per share, return on equity, net income margin and liquidity or current ratio. The earnings per share represents the proportion of the overall profit of the company that is distributed to each individual share of the stock (Batchimeg, 2017). In

addition to this, the earning per share ratio is of huge importance for investors, and for individuals who practice trading in stock markets. This has also been argued in the study of Mohapatra (2019) that the profitability of the company is determined by the high ratio of earning per share. Therefore, it is one of the significant determinant while measuring the financial performance of company. On the other hand, the return on equity is also regarded as the significant ratio which is use to predict the financial performance of a company. This has also been contended in the study of Rai et al. (2018) that ROE is a profitability ratio which depicts the amount of company's profitability that is caused as a proportion of shareholder's equity. According to Daly and Frikha (2017), the ROE ratio is an important determinant of the financial performance of the company, as it explains the company capability in terms of generating the cash internally.

Moreover, the net income margin has also been identified as the significant determinant of the company's performance. This is due to the reason that net income margin is recognised as profit margin, which depicts the overall profitability of the company. The study of Ferrouhi (2018) also argues that net income margin ratio measures the net profit or income which is generated as a proportion of company's revenues. Similarly, it can also be stated that net profit margin refers to the proportion of revenues remained after the exclusion of interest, operating expenses, preferred stock dividends and taxes. Therefore, net profit margin is among the most useful financial measure to analyse the performance of company. On the other hand, the current ratio or liquidity ratio has also been identified as one of the determinants of financial performance of the company. The study of Matar and Eneizan (2018) argued that this is due to the purpose that the current ratio is regarded as one of the most prominent metrics which is utilised across different industries to measure the firm's short-term liquidity in relation to its impending liabilities and available asset. In a similar manner, this ratio reveals the ability of the company in terms of generating sufficient amount of

cash to pay-off all of its debt. Therefore, this ability of the company is considered as an important measure to assess financial health of that company.

Objective 3: To evaluate the impact of financial leverage on the banking performance of the UK

The third objective of the study was to evaluate the impact of financial leverage on the banking performance of UK. The analysis identified that there is no significant impact of the financial leverage on the net profit margin of companies. However, the study of Kiet, and Thuan, (2019) argues that financial leverage for the banking sector is the most significant element as the banks are usually operating on the fixed amount of profit which is being earned through the interest earned upon the loans provided by the bank. It has also been identified that there is significant impact of the financial leverage on earnings per share, return on equity and current ration. This has also been supported in the study of Oketch, Namusonge, and Sakwa (2018) that the banking structure mainly rely over the debt as there are number of sources which provides the cash to the bank and makes it easier for them to continue their business process. The main source of money includes the amount being deposited by the account holders, investors, fixed depositors and central banks. In this manner, it makes clear that the banks are also liable to pay interest which have share in the investment for the company. Moreover, it was studied that the rate of interest that the banks collect from the borrowers and the rate of interest being paid by the banks is unlike (Sodeyfi, 2016). However, the banks are the bodies which decreases the risk of investors therefore they also pay the lower amount of interest to their investors.

In this manner, the probability to earn profit is directly proportional to rate of risk that the investor is going to bear either in the long term or short term. Moreover, it has also been identified that the banks usually have staff and procedures for the purpose of evaluating the risk prior providing loans while assuring that their investment will be recovered in each possible outcome

(Bui, 2020). However, in the context of UK banking sector, it was identified that the leverage of banking sector is higher than the other countries as most of the people in UK are relying over debt even for their basic necessities of life (Elahi, 2017).

4.10 Implication and limitation for your study

The main limitation of the study is that it is geographical restriction as the research is conducted by focusing over the UK, so this study cannot be applied over other regions. The research can be applied only over such countries whose financial structure is same as UK so it is recommended that for future the research would be conducted generally or some other part of the world would be selected for the research. In addition to this the research is conducted by following quantitative research design, in order to get more effective result, the research would be conducted by following qualitative research design in future which also helps in gaining perspective of people working in financial sector.

4.11 Chapter Summary

The chapter presents how financial leverage of the banks have been affecting the financial performance and liquidity position of the banks in United Kingdom. The empirical investigations in chapter reveals that debt to equity and debt to assets ratio have statistically insignificant relation with EPS, ROE, NPM and current ratio; but loan to deposit ratio has negative relation with EPS and positive relation with current ratio significantly. Furthermore, EPS of the banks is negatively affected by debt to assets and loan to deposits ratio and positively by debt to equity; whereas second model reveals that only debt to assets and loan to deposits have negative and significant effect on ROE. In addition to, NPM is not affected by the financial leverage of the banks; whereas

last model reveals that debt to assets ratio negatively affect liquidity position of banks and that debt to equity positively affects liquidity.

CHAPTER 5: CONCLUSION AND RECOMMENDATION

5.1. Introduction

This section includes the conclusion of the study which has been conducted on identifying the effects of financial leverage on the banking performance of UK. In this method, the summarised findings are provided in this section of the study which are based on the analysis and discussion. Additionally, the future implications are also included in this chapter of the study which provides guidance to the future researchers pertaining to the limitations of this study. Besides, the recommendations for companies operating in the banking sector are also provided in this section of the study which are based on the analysis and findings of the study. Furthermore, the conclusion is provided at the end of this chapter.

5.2. Summarised Findings

The study has been carried out to identify the effect of financial leverage on the banking performance of UK. In this manner, it has been identified that financial leverage is employed to enhance the return on equity. However, there is an excessive amount of financial leverage which mainly enhances the failure of risk while making it more difficult to repay the debt. On the other hand, it has also been identified that financial leverage is supportive for the company when it can be used for which debt can bring together for the purpose of generating the returns greater in contrast to the interest expense which is associated with the debt. In contrast, the financial leverage helps the company in earning more revenues while causing relaxation in the tax. This depicts the significance of financial leverage for the company.

Moreover, it has also been identified that financial leverage might allow the entity for earning a disproportionate amount over the assets which the business owns. However, the financial leverage may increase the likelihood of inconsistent losses in which the related extent of interest

expense strengthen the borrowers if they are not able to earn adequate returns for the purpose of offsetting the interest expense. In addition to this, the financial leverage can be considered as an acceptable alternative of the company has been operating in the competitive industry along with the large cash reserves, firm revenue level and high obstructions to entry. Therefore the operating conditions are adequately stable for supporting in a great amount of leverage with slight downside. In this manner, the financial leverage has been of most significance for the companies operating in the banking sector of UK.

Pertaining to the factors or determinants that effect the financial performance of the organisations, it has been identified that there are four factors or determinants which can affect the financial performance of the companies. These factors include the earnings per share, return on equity, net income margin and liquidity or current ratio. The discussion identified that the earnings per share represents the proportion of the overall profit of the company that is distributed to the individual share of the stock. Moreover, the earning per share ratio is of huge importance for investors, and for individuals those take interest in making investments. It is also identified that the profitability of the company is determined by the high ratio of earning per share. In this manner, of the performance of the company will be better, it will attract more investors which will eventually increase the debt of company. Therefore, earnings per share is one of the significant determinants while measuring the financial performance of company.

The return on equity was also recognised as one of the determinants of financial performance of the company. This is due to the purpose that the ROE is a profitability ratio which depicts the amount of company's profitability that is caused as a proportion of shareholder's equity. Therefore, the ROE ratio is a significant determinant of the financial performance of the company, as it explains the company's capability in terms of generating the cash. The other

determinant is net profit margin for the purpose of determining the performance of the company. This is due to the reason that net income margin is considered as profit margin, which depicts the overall profitability of the company. In addition to this, it has also been identified that net profit margin ratio measures the net profit or income which is generated as a proportion of company's revenues.

In addition to this, the study also identified that net profit margin refers to the proportion of revenues remained after the exclusion of interest, operating expenses, preferred stock dividends and taxes. On the other hand, the current ratio or liquidity ratio has also been identified as one of the determinants of financial performance of the company. This is due to the reason that the current ratio is considered as one of the most prominent metrics which is adopted in different industries for the purpose of measuring the firm's short-term liquidity in relation to its impending liabilities and available asset. On the other hand, it has been recognised that there has been significant impact of the financial leverage on the earnings per share, return on equity and current ratio. However, there is no significant impact of financial leverage on the net profit margin.

5.3. Future Implications

This study has intensive on the effects of financial leverage on the banking performance of UK. However, there are several limitations of this study which must be deliberated by the future researchers in order to make significant and broader contributions towards this area of the study. Firstly, this study has focused in the effects of financial leverage on the banking sector. There are several other factors that affect the banking industry which must be considered by the future researchers. Alternatively, the study has concentrated on the effect of financial leverage on banking sector only. It is recommended that other sectors must also be identified in terms of having effect

of financial leverage. Lastly, the study has only intensive on the banking performance of UK. It is suggested for the future investigators to include banking sectors of other counties in Europe. This will help them in growing the range of the study.

5.4. Recommendations

Based on the analysis regarding the effect of financial leverage on the banking performance of UK, there are several recommendations developed for the companies operating in the banking sector of UK. These recommendations are delivered below:

- It is suggested for the companies to focus in the identification of the most ideal level of leverage for banks in order to make sure that financing risk should not exceed too far from the tolerable limit. This is due to the reason that it will decrease the returns for shareholders while negatively affecting the overall profitability of the organisation.
- It is also recommended to the companies operating in the banking sector of UK to evaluate the financial system of the company. This is due to the reason that the efficiency can be ensured with the help of healthy financial system along with the efficient economy. In this manner, the banks should must evaluate as well as analyse carefully.
- Lastly, it is also recommended for the companies to focus more on the earnings per share, return on equity and current ratio. This is due to the reason that there is a significant impact of financial leverage on these performance indicators which will enhance the performance of the companies in the industry.

5.5. Conclusion

The most effective financial plan comprises of the proper ratio of debt and equity that is required for investment. However, it is highly difficult for organisations to undertake the

operations that are comprised of debt and equity. In this manner, the effect of financial leverage on the banking performance of UK has been studied in this paper. The determinants of financial leverage were identified as the debt to equity ratio, debt to asset ratio and interest coverage ratio. On the other hand, the determinants of financial performance were identified as the earnings per share, return on equity, net income margin and current ratio. The data was gathered from the secondary sources of information for the purpose of determining the impact of financial leverage on the banking performance of the UK. The data was analysed quantitatively using the correlation and regression analysis methods.

From the analysis, it can be determined that there has been a significant impact of financial leverage on the earnings per share, return on equity and current ratio. However, the impact of financial leverage on the net profit margin was not found to be significant. In this manner, it is recommended for the companies to focus more on the earnings per share, return on equity and current ratio. As there is a significant impact of financial leverage on these performance indicators which will enhance the performance of the companies in the industry.

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