

ABSTRACT

This study contributes to and updates existing literature on the impact of the degrees of operating and financial leverage on the systematic risk of firms and their common stock. It also examines the existence of trade – off (i.e. negative correlation) between degrees of operating and financial leverage. 160 randomly selected UK public companies were analysed from 2003 to 2009 with the aid of OLS regression and correlation analysis. OLS regression analysis was carried out at the individual firm level and also used the portfolio grouping approach while correlation analysis was performed using only the portfolio grouping approach. The portfolio grouping approach was adopted to remove any selection bias that might be present within the sample and ensure data used for the analysis was stationary.

A positive significant relationship is found to exist between systematic risk and both degrees of operating and financial leverage. For the entire sample, the result of this study could not confirm the existence of trade – off between the degrees of operating and financial leverage. However on isolating four industries within the sample with the highest weights, i.e. manufacturing, travel and leisure, retailers and support services industries, the result obtained at these industry levels gave some evidence to the existence of trade – off between degrees of operating and financial leverage especially in the manufacturing and travel and leisure industries. This suggests that the trade – off between degrees of operating and financial leverage might exist in certain industries and not exist in some others. In other words, the existence of trade – off between degrees of operating and financial leverage might be industry dependent.